

Facilitating Successful Failures

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Michelle M. Harner and Jamie Marincic Griffin, *Facilitating Successful Failures*, 66 Fla. L. Rev. 205 ().
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FACILITATING SUCCESSFUL FAILURES

Michelle M. Harner^{*} & *Jamie Marincic Griffin*[†]

Abstract

Approximately 80,000 businesses fail each year in the United States. This Article presents an original empirical study that surveys more than 400 business restructuring professionals. The study focuses on a critical factor that arguably contributes to these failures—the conduct of boards of directors and management. Anecdotal evidence suggests that management of distressed companies often bury their heads in the sand until it is too late to remedy the companies’ problems, a phenomenon commonly called “ostrich syndrome.” The data confirm this behavior, shows a prevalent use of loss framing, and suggest trends consistent with prospect theory. This Article draws on both the data and behavioral economics to examine the genesis and contours of this problem. It then discusses potential changes to applicable law and introduces a new “meet and confer” process to encourage timely restructuring negotiations. The meet and confer process is designed to promote meaningful changes in management conduct and to facilitate more “successful failures.” Policymakers should adopt regulations that foster this mentality, rather than rewarding fear or ignorance in the face of failure.

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*Failure is simply the opportunity to begin again,
this time more intelligently.*
-Henry Ford¹

INTRODUCTION

Almost every company experiences financial distress at one point or another in its life cycle. Small businesses frequently incur significant losses for the first several years of operation, and many of those companies never realize a profit.² Companies that do eventually realize

1. Scott Allen, *Henry Ford—Founder of Ford Motor Company and Assembly Line Innovator*, ABOUT.COM: ENTREPRENEURS, <http://entrepreneurs.about.com/od/famousentrepreneurs/p/henryford.htm> (last visited Dec. 28, 2012).

2. See, e.g., U.S. SMALL BUS. ADMIN., FREQUENTLY ASKED QUESTIONS: ADVOCACY: THE VOICE OF SMALL BUSINESS IN GOVERNMENT, *available at*

a profit often are, over time, unable to maintain those profits and growth.³ Even the most mature companies face financial challenges. Why then do some companies flourish despite (or perhaps because of) these challenges, while others collapse under the pressure?

There likely is no single explanation, but one predominant factor is company management. Playing on the words of James Carville during the 1992 presidential race, “It’s the people, stupid.”⁴ The timing and substance of management’s decisions in the face of financial uncertainty are critical to the end result, regardless of what caused the distress in the first instance. Yet, those outside of that decision-making process often know relatively little about it, other than the loud criticism the public voices upon a company’s failure or the frequently empty praise it sings upon a company’s success.

This Article presents an in-depth analysis of the role that management and boards of directors play in the resolution of companies’ financial distress. It uses the results of an original empirical survey of restructuring professionals along with behavioral economics to evaluate management decisions and the role of federal bankruptcy law in those decisions. Although every financial restructuring is unique in one or more respects, the data show common themes that underlie many cases and thus can guide policy reform in the insolvency context.

No one likes to admit failure.⁵ This adage is true for most people, including boards of directors, chief executive officers, and other top executives in corporate America. Understanding this adage can facilitate an understanding of the choices management makes in the face of financial distress. Indeed, the adage underlies the “ostrich syndrome” that the corporate restructuring community frequently bemoans.⁶

<http://www.sba.gov/sites/default/files/sbfaq.pdf> (last updated Jan. 2011) (noting that while seven out of ten small businesses survive their first two years of operations, only five out of ten survive more than five years).

3. For a general description of business failures in the United States, see DUN & BRADSTREET, D&B U.S. BUSINESS TRENDS QUARTERLY REPORT (2011), *available at* http://www.dnb.com/content/dam/english/economic-and-industry-insight/us_business_trends_201109.pdf (last visited Jan. 27, 2013) (explaining the status of U.S. business failures currently estimated at approximately 80,000 per year in 2010 and 2011, and providing historical data reflecting similar levels of failure); DUN & BRADSTREET, D&B U.S. BUSINESS TRENDS REPORT (2011), *available at* http://www.dnb.com/content/dam/english/economic-and-industry-insight/us_business_trends_201101.pdf (last visited Jan. 27, 2013).

4. *See, e.g.*, Bill Schneider, *Analysis: Could It Be ‘The Economy, Stupid’ Again?*, CNN (Nov. 8, 2007), <http://www.cnn.com/2007/POLITICS/11/07/schneider.economy.poll/indexhtml>.

5. *See, e.g.*, Mark V. Pezzo & Stephanie P. Pezzo, *Making Sense of Failure: A Motivated Model of Hindsight Bias*, 25 SOC. COGNITION 147, 148 (2007) (explaining, among other things, two common responses to failure—“defensive processing” and “retroactive pessimism”—both of which deny accountability).

6. *See, e.g.*, Michelle M. Harner, *Discussing the “B” Word with Corporate Boards*, CREDIT SLIPS (June 17, 2010, 9:10 AM), <http://www.creditslips.org/creditslips/2010/06/discussi>

Ostrich syndrome refers to management's tendency to stick its collective head in the sand and ignore the warning signs of financial distress until it is too late to effectively resolve that distress.

Admittedly, the timing to initiate effective restructuring negotiations is more art than science. It is a sensitive matter subject to many contingencies and factors, some of which are beyond management's control. Nevertheless, a delay in restructuring discussions may place management in a weaker negotiating position with key creditor constituencies and allow short-term investors, whose interests may not necessarily align with others, to amass large holdings in the company's capital structure. As a result, management may have fewer options once it finally starts restructuring discussions.

Why is it difficult for individuals to admit either mistakes or failure, and what can or should the law do about it? The vast literature on behavioral economics offers some insight into the former,⁷ and the growing body of literature studying behavioral economics in corporate boardrooms has started to influence the latter.⁸ This Article further

ng-the-b-word-with-corporate-boards.html; John Tribe, *Symptoms of Debtor Ostrich Syndrome?*, BANKR., INSOLVENCY & CORP. RESCUE (Apr. 10, 2009, 8:02 AM), <http://bankruptcyandinsolvency.blogspot.com/2009/04/symptoms-of-debtor-ostrich-syndrome-r3s.html> (explaining "that those with financial problems do not think they 'need' debt advice, while those that do seek advice are not always going to the right places for it"). As an example, former CEO of Circuit City Alan L. Wurtzel said, in an interview after the company's bankruptcy, that he wished the company had woken up sooner, but instead, "management ushered in the new century with largely the same strategy" the company had developed during 1980, continuing to provide services customers no longer wanted. Rachel Feintzeig, *Lessons from the Death of Circuit City*, WALL ST. J. BLOG (Oct. 25, 2012, 4:47 PM), <http://blogs.wsj.com/bankruptcy/2012/10/25/lessons-from-the-death-of-circuit-city>. Wurtzel commented, "It wasn't obvious in sales and earnings, but the rot had set in." *Id.*

7. "Behavioral Economics is the combination of psychology and economics that investigates what happens in markets in which some of the agents display human limitations and complications." Sendhil Mullainathan & Richard H. Thaler, Abstract, *Behavioral Economics* (Nat'l Bureau of Econ. Research, Working Paper No. 7948, 2000), available at <http://www.nber.org/papers/w7948.pdf>; see also Craig Lambert, *The Marketplace of Perceptions*, HARV. MAG., Mar.-Apr. 2006, at 50, available at <http://harvardmag.com/pdf/2006/03-pdfs/0306-50.pdf> (explaining development of behavioral economics). But see, e.g., Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551, 1551-55 (1998) (criticizing behavioral economics).

8. See Stephen M. Bainbridge, *Why a Board? Group Decisionmaking in Corporate Governance*, 55 VAND. L. REV. 1, 2-3 (2002); Margaret M. Blair & Lynn A. Stout, *Trust, Trustworthiness, and the Behavioral Foundations of Corporate Law*, 149 U. PA. L. REV. 1735, 1807-10 (2001); Regina F. Burch, *The Myth of the Unbiased Director*, 41 AKRON L. REV. 509, 510-14 (2008); James D. Cox & Harry L. Munsinger, *Bias in the Boardroom: Psychological Foundations and Legal Implications of Corporate Cohesion*, LAW & CONTEMP. PROBS., Summer 1985, at 83, 83-84, 99-108; Lawrence A. Cunningham, *Beyond Liability: Rewarding Effective Gatekeepers*, 92 MINN. L. REV. 323, 363-65 (2007); Lynne L. Dallas, *A Preliminary Inquiry into the Responsibility of Corporations and Their Officers and Directors for Corporate Climate: The Psychology of Enron's Demise*, 35 RUTGERS L.J. 1, 2-4 (2003) [hereinafter Dallas,

develops this literature with its focus on heuristics (i.e., mental shortcuts to facilitate quick decisions) and cognitive bias in the distressed corporate boardroom. The representative heuristic, overconfidence and optimism biases, and framing effects can impede management's decisions in distressed situations. Policymakers—as well as business executives and professionals—must consider these behavioral traits when they design and implement federal bankruptcy law.⁹

For example, restructuring professionals and commentators often talk about filing for bankruptcy as a distressed company's "option of last resort." They typically use this expression to underscore the need for a distressed company to appreciate the significance of filing a Chapter 11 reorganization case. Such a filing has broad and potentially negative consequences and corporations should not undertake this process lightly.¹⁰ The Chapter 11 process does, however, offer a

Psychology of Enron's Demise]; Lynne L. Dallas, *Two Models of Corporate Governance: Beyond Berle and Means*, 22 U. MICH. J.L. REFORM 19, 73–79 (1988) [hereinafter Dallas, *Beyond Berle and Means*]; Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 583–85 (2002); Donald C. Langevoort, *The Human Nature of Corporate Boards: Law, Norms, and the Unintended Consequences of Independence and Accountability*, 89 GEO. L.J. 797, 812–13 (2001) [hereinafter Langevoort, *Human Nature*] (discussing the effect of personal relationships on information sharing between managers and boards); Donald C. Langevoort, *Organized Illusions: A Behavioral Theory of Why Corporations Mislead Stock Market Investors (and Cause Other Social Harms)*, 146 U. PA. L. REV. 101, 107 (1997–1998) [hereinafter Langevoort, *Organized Illusions*] (discussing managers' various constituencies, motivations to lie, and why regulations do not adequately deter misleading behavior); Donald C. Langevoort, *Resetting the Corporate Thermostat: Lessons from the Recent Financial Scandals About Self-Deception, Deceiving Others and the Design of Internal Controls*, 93 GEO. L.J. 285, 288 (2004) [hereinafter Langevoort, *Corporate Thermostat*]; Oliver Marnet, *Behavior and Rationality in Corporate Governance*, 39 J. ECON. ISSUES 613, 614, 619 (2005); Marleen A. O'Connor, *The Enron Board: The Perils of Groupthink*, 71 U. CIN. L. REV. 1233, 1237 (2003); Antony Page, *Unconscious Bias and the Limits of Director Independence*, 2009 U. ILL. L. REV. 237, 286–89. See generally Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499, 1502 (1998) [hereinafter Langevoort, *Literature Review*] (discussing the increasing acceptance of "[b]ehavioral economics" in prominent economics and finance journals).

9. See, e.g., Hersh Shefrin, *Behavioral Corporate Finance*, J. APPLIED CORP. FIN., Fall 2001, at 113, 113, 117–18 (providing examples of overconfidence leading to poor corporate decision-making); Dan Lovallo & Daniel Kahneman, *Delusions of Success: How Optimism Undermines Executives' Decisions*, HARV. BUS. REV., July 2003, at 56, 58 (examining cognitive biases applicable to business decisions).

10. Although potential operational disruptions and reputational harm can be mitigated with proper preparation, a company that files Chapter 11 may experience both. For example, the automatic stay of § 362 of the Bankruptcy Code often halts payments to vendors and trade creditors (and sometimes even employees), and management must anticipate and address these types of issues in order to maintain products and services at pre-bankruptcy quality and quantity standards. Moreover, historically, bankruptcy suggested a lack of financial responsibility, and a stigma attached to individuals and companies that sought bankruptcy protection. Several

distressed company tools not otherwise available outside of bankruptcy, and the utility of those tools frequently turns on the timing of the bankruptcy filing.¹¹ Accordingly, most restructuring professionals use the term “last resort” loosely, not necessarily to mean “use only if all else fails,” but to encourage careful deliberation of the matter.¹²

But is that what a distressed company’s management hears? The term “last resort” typically means “you do it because you can find no other way of getting out of a difficult situation or of solving a problem.”¹³ Thus, the phrase “filing bankruptcy should be your option of last resort” may mean one thing to the restructuring professional and something completely different to a business executive not trained in bankruptcy parlance. It also might enable any heuristics and cognitive biases management harbors and confirm management’s entrenched views regarding any bankruptcy filing or the potential success of its existing business plan.¹⁴

We conducted an extensive empirical survey of business restructuring professionals to test a basic hypothesis they developed through anecdotal evidence: Management of distressed companies often deny the extent of their companies’ distress and delay discussions of a Chapter 11 bankruptcy filing. Over 400 restructuring professionals responded to the empirical survey (the Management Behavior Study). The survey data confirm the basic hypothesis and show some troubling trends. For example, the overwhelming majority of respondents use the phrase “bankruptcy as a last resort” with distressed clients.¹⁵ Moreover, respondents who never used the phrase were significantly more likely to

commentators and anecdotal evidence suggest that this stigma no longer exists, but it also is a factor that companies must consider. *See, e.g.,* Michelle M. Harner, *The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing*, 77 *FORDHAM L. REV.* 703, 729 & n.150 (2008).

11. Such tools include the debtor’s ability to decide unilaterally (for the most part) to assume or reject contracts and leases, to obtain financing that primes existing liens (thus providing a source of capital not available outside of bankruptcy), to sell some or all of its assets free and clear of all liens and claims, and to delay the payment of and restructure its prepetition obligations while continuing to operate the business. *See, e.g.,* 11 U.S.C. §§ 362 (the automatic stay), 363 (asset sales), 364 (financing), 365 (contracts and leases), 1129 (plan confirmation provisions) (2006).

12. *See infra* Subsection II.C.2.

13. COLLINS COBUILD ENGLISH DICTIONARY FOR ADVANCED LEARNER’S ENGLISH DICTIONARY (4th ed. 2003).

14. For example, a framing bias may alter what management hears and in turn bolster any confirmation or overconfidence bias influencing management’s decisions. “[F]raming bias is the tendency to view a given problem in different terms depending on the perspective from which the problem is viewed.” Ian Weinstein, *Don’t Believe Everything You Think: Cognitive Bias in Legal Decision Making*, 9 *CLINICAL L. REV.* 783, 796–97 (2003) (describing the cognitive bias known as framing or anchoring).

15. *See infra* Subsection II.C.2.

have a client who initially refused, but ultimately did, file a bankruptcy case.¹⁶ That data may suggest those clients successfully restructure outside of the bankruptcy process or, more troubling, signal prospect theory at work: Professionals use a loss frame to discuss bankruptcy, and distressed clients pursue riskier out-of-court solutions that at best provide only short-term solutions.

Better understanding management's decisions in the face of a company's distress can lead to better policies and outcomes. This Article makes original and meaningful contributions to this dialogue. Part I provides relevant background information about the restructuring alternatives for distressed companies as well as the heuristics and biases that potentially impact decision-making in this context. Part II then presents original empirical data and examines the data in light of the behavioral economics literature and prior studies. Part III uses these analyses to evaluate the existing restructuring landscape and suggests legislative reforms to mitigate the negative effects of heuristics in the distressed company context. These reforms include a revamp of the hybrid restructuring options for distressed companies that provides incentives and stronger legislative support for companies that begin restructuring discussions in a timely manner.¹⁷ This Article concludes by encouraging policymakers, professionals, and business executives to further consider how heuristics might impede successful reorganizations and to integrate countermeasures into both bankruptcy legislation and strategy discussions to foster more successful failures.

I. FINANCIAL DISTRESS AND MANAGEMENT DECISION-MAKING

Companies experience distress for a variety of reasons, both systemic and idiosyncratic.¹⁸ Systemic risk refers to factors that affect

16. See *infra* Subsection II.C.4; cf. Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 *ECONOMETRICA* 263, 268–69 (1979) (discussing how individuals are more likely to take risks when they face two negative prospects).

17. See *infra* Subsection III.B.1 (discussing the new concept of “meet and confer” process, or an MCP, that provides a more effective quasi-judicial option for distressed companies).

18. See, e.g., Dean Anderson & Elliot A. Fuhr, *Diagnosing Distressed Companies: A Practical Example*, *AM. BANKR. INST. J.*, Oct. 1994, at 9, 9 tbl.1 (“Major Warning Signs of Financial Distress: Declining Net Income; Decreasing or Inadequate Margins; Creditors Unwilling to Advance Credit; Loss of a Major Supplier with Special Credit Terms; Reduction in Lines of Credit; Excessive Receivables over 90 Days; Default on Payment by a Major Customer; Excessive Payables Unpaid over 90 Days; Inability to Make Timely Deposits of Trust Funds such as Employee Withholding Taxes; Inability to Service Long-Term Debt Requirements; Excessive Re-negotiation of Broken Loan Covenants; Unusual or Extraordinary Litigation and Events Not Customarily Encountered in the Industry; Loss of Key Financial Officers or Key Personnel; Cash Management Becoming a Primary Activity at the Expense of Traditional Management Functions; New Long-Term Financing Proceeds Applied to Pay Off Debts Rather Than Acquisition of Assets; Poor Record Keeping or Inadequate Financial

entire industries or markets and are not unique to a particular company.¹⁹ The economic turmoil and resulting recession in 2008 highlighted the global instability that systemic risk can trigger. Idiosyncratic risk refers to internal factors often specific to a particular company, such as its business lines, capital structure, or management activity or inactivity.²⁰ Moreover, systemic risk can accelerate idiosyncratic risk and compound a company's distress and restructuring efforts.

Notably, when a company undertakes either an in- or out-of-court restructuring, management focuses on the systemic and external factors that cause the company's distress. Press releases frequently tout a weak economy and softening customer demand as key drivers behind a company's decision to file a Chapter 11 case.²¹ Management rarely identify idiosyncratic factors or risks that either their own decisions or their strategic objectives cause.

Management's reluctance to acknowledge responsibility for a company's distress may be a natural human response, given individuals'

Records; Lack of Basic Controls, such as Perpetual Inventory Record Keeping; Significant Discrepancies Between Actual and Projected Results over the Prior Three Years.”). The company Dun & Bradstreet uses several of these indicators to provide credit scores and supplier evaluation risk summaries for businesses. *Instructional Guide*, D&B, <https://www.dnb.com/sassmo/help/InstructionalGuide.htm> (last visited Jan. 27, 2013).

19. One commentator notes:

A common factor in the various definitions of systemic risk is that a trigger event, such as an economic shock or institutional failure, causes a chain of bad economic consequences—sometimes referred to as a domino effect. These consequences could include (a chain of) financial institution and/or market failures. Less dramatically, these consequences might include (a chain of) significant losses to financial institutions or substantial financial-market price volatility. In either case, the consequences impact financial institutions, markets, or both.

Steven L. Schwarcz, *Systemic Risk*, 97 GEO. L.J. 193, 198 (2008).

20. See, e.g., Robert Ackerman & Elizabeth Chorvat, *Modern Financial Theory and Transfer Pricing*, 10 GEO. MASON L. REV. 637, 671 (2002) (discussing one way idiosyncratic risk can work in practice by comparing inventory assets in the hands of a distributor as opposed to a local retailer); James C. Spindler, *IPO Liability and Entrepreneurial Response*, 155 U. PA. L. REV. 1187, 1189 n.2 (2007) (“‘Idiosyncratic,’ ‘unique,’ ‘firm-specific,’ or ‘diversifiable’ risk is risk that is particular to that specific firm.”).

21. Affidavit of Richard Golden in Support of First Day Motions and Applications at ¶ 15, *In re UFood Restaurant Grp.*, No. 12-19702 (Bankr. D. Mass. Dec. 14, 2012) (“[D]ue to economic downturn, the Debtors’ slow recovery there from, and certain other factors, certain of the company-owned UFood Outlets are struggling and are a drag on the Debtors’ businesses.”); Affidavit of Antoinette P. McCorvey at ¶ 10, *In re East Kodak Company*, No. 12-10202 (Bankr. S.D.N.Y. Jan. 19, 2012) (“Since 2008, despite Kodak’s best efforts, restructuring costs and recessionary forces have continued to negatively impact the Company’s liquidity position . . .”).

general reluctance to take ownership of their mistakes.²² Heuristics may reinforce this reaction. Several studies explore the impact on CEO and board decisions of confirmation and overconfidence biases.²³ These potential management flaws can prove fatal to a distressed company. They may skew management's perception of the company's financial health and may delay necessary operational and restructuring activities. How a distressed company's professionals frame and discuss with management the company's restructuring alternatives may further enable these biases.

This Part explains the basic legal and behavioral economics arguments pertinent to an analysis of management decision-making in the distressed company context. It first outlines the restructuring alternatives for a distressed company by summarizing the in- and out-of-court options likely available to a distressed company. It then considers behavioral economics literature and its relevance to corporate boardrooms.

A. *Restructuring Alternatives*

A troubled company may experience financial distress, economic distress, or both. Financial distress generally refers to the financial condition of the company, including its leverage, financial obligations to creditors, and ability to meet those obligations.²⁴ Economic distress, on the other hand, refers to weaknesses in the company's business model and operations.²⁵ Although economic distress can lead to financial distress, the reverse progression can also occur, and cause the untimely demise of a profitable business model. In both cases, the

22. See, e.g., Eugene Sz wajkowski, *Accounting for Organizational Misconduct*, 11 J. BUS. ETHICS 401, 402 (1992) (describing the literature on the failure-to-take-responsibility phenomenon and noting how the discovery of organizational misconduct creates a predicament for a manager because the event may "cast[] undesired aspersions on the lineage, character, conduct, skills, or motives" of the manager, which may damage the individual's social and professional standing).

23. See, e.g., Burch, *supra* note 8, at 531; Cunningham, *supra* note 8, at 350–51; Dallas, *Psychology of Enron's Demise*, *supra* note 8, at 37; Dallas, *Beyond Berle and Means*, *supra* note 8, at 98–99; Greenfield, *supra* note 8, at 586; Langevoort, *Human Nature*, *supra* note 8, at 812–13; Langevoort, *Organized Illusions*, *supra* note 8, 139–142; Langevoort, *Corporate Thermostat*, *supra* note 8, at 299–302; Marnet, *supra* note 8, at 613–14; Page, *supra* note 8, at 265–66.

24. Lemma W. Senbet & Tracy Yue Wang, *Corporate Financial Distress and Bankruptcy: A Survey*, 5 FOUNDATIONS & TRENDS IN FIN. 243 (2012) (manuscript at 7), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2034646.

25. *Id.*; see also Michael L. Lemmon, Yung-Yu Ma & Elizabeth Tashjian, *Restructuring and Post Emergence Performance of Bankrupt Firms: Evidence from the Post-1991 Period* 10, 12–13 (Apr. 12, 2011) (unpublished manuscript) (on file with author) ("Lower operating performance is associated with a greater degree of economic distress . . .").

substance and timing of management's decisions are critical to the company's ultimate success.²⁶

What constitutes success in the restructuring context is subject to debate. Some commentators focus on maximizing the business's value while others emphasize rehabilitating the business and preserving jobs and economic development.²⁷ An optimal restructuring strikes a balance between these competing goals and facilitates the reorganization of economically viable firms. Economic viability may result from deleveraging and, in some cases, revamping the business model.²⁸ Again, both outcomes largely depend on management's restructuring path.

Most commentators agree that management should pursue out-of-court restructuring options before filing for bankruptcy.²⁹ Bankruptcy

26. See Lemma W. Senbet & James K. Seward, *Financial Distress, Bankruptcy and Reorganization*, in 9 HANDBOOKS IN OPERATIONS RESEARCH AND MANAGEMENT SCIENCE 921, 951–53 (R.A. Jarrow et al. eds., 1995) (discussing how managerial ability and decision-making are important determinants of firm value both generally and when the firm is in distress).

27. See *In re Cent. Ice Cream Co.*, 836 F.2d 1068, 1072 (7th Cir. 1987) (suggesting that value maximization should be the goal of Chapter 11); Hon. Leif M. Clark et al., *What Constitutes Success in Chapter 11? A Roundtable Discussion*, 2 AM. BANKR. INST. L. REV. 229, 229–33 (1994) (discussing how a Chapter 11 case that provides workers with time to find new jobs is more successful than a Chapter 7 case with immediate job termination); James H.M. Sprayregen et al., *Chapter 11: Not Perfect, but Better than the Alternatives*, 14 J. BANKR. L. & PRAC. 6 art. 1 (2005) (noting two perspectives among Chapter 11 scholars, the “rehabilitationists” who view the rehabilitative aspects of Chapter 11 as valuable and those who think the current process is not useful).

28. See Lemmon, *supra* note 25, at 10, 12 (noting that firms classified as financially distressed are primarily distressed by high leverage but have “fundamentally sound business models”, whereas firms classified as economically distressed are characterized by “a business model with fundamental problems” and operating performance is the dominant source of distress); FINANCIER WORLDWIDE, BANKRUPTCY & RESTRUCTURING COMPENDIUM 2012, at 152 (document on file with the Florida Law Review) (discussing large-scale bank deleveraging); *id.* at 60 (discussing business model changes in the airline industry).

29. See Karen M. Gebbia-Pinetti, *First Report of the Select Advisory Committee on Business Reorganization*, 57 BUS. LAW. 163, 179 (2001); Hon. Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 365 (1993) (noting that out-of-court workouts, when successful, are typically more beneficial to all parties than when a company utilizes the bankruptcy courts); Stuart C. Gilson, Kose John & Larry H.P. Lang, *Troubled Debt Restructurings: An Empirical Study of Private Reorganizations of Firms in Default*, 27 J. FIN. ECON. 315, 319 (1990); see also Randolph J. Haines, *Bankrupting the Opposition*, 21 LITIG., Summer 1995, at 38, 40 (“Out-of-court workouts, even if they mean accepting pennies on the dollar, are usually quicker and cheaper than any bankruptcy, and therefore likely to return more to creditors. Moreover, the out-of-court workout probably stands a greater chance of permitting the debtor to remain in business, and thus be a valuable customer in the future.”); Bettina M. Whyte & Patricia D. Tilton, *Turnarounds: Pursuing a Dual Path*, AM. BANKR. INST. J., Nov. 1995, at 28, 28 (“Generally speaking . . . an out-of-court workout is preferable to reorganizing under the Code due to the cost, image, drain on resources, impact on morale, etc. of a bankruptcy.”).

can be a lengthy and expensive process.³⁰ Nevertheless, each option deserves independent consideration because each has particular advantages that depend on the company's circumstances. To maximize the utility of any option, management must understand and remain open to all restructuring options. As described below, the prospects of a Chapter 11 case might encourage an out-of-court restructuring or streamline the bankruptcy process through a prepackaged bankruptcy case.³¹

1. Out-of-Court Restructurings

An out-of-court restructuring typically involves a consensual agreement between the company and its major creditors to adjust the company's capital structure. It also may accompany or facilitate an operational restructuring. The key attributes of most successful out-of-court restructurings include a concentrated creditor group and a good working relationship between the company and its creditors, vendors, and suppliers. Although simple in concept, a private, consensual resolution can prove challenging to achieve because even one dissenting creditor can often derail the entire restructuring.

The dissenting or "holdout" creditor's power stems largely from provisions in both a company's prepetition debt instruments and the Indenture Trust Act of 1939. For example, a credit facility or indenture might require a supermajority or unanimous voting threshold in order to waive certain defaults, request forbearance, or take other necessary actions to achieve the desired restructuring.³² Likewise, the Indenture Trust Act of 1939 provides that an indenture may not affect an individual bondholder's right to receive the "payment of the principal of and interest . . . on or after the respective due dates . . . or to institute suit for the enforcement of any such payment" without the consent of

30. See Gebbia-Pinetti, *supra* note 29, at 183–84 (noting that the many expenses associated with bankruptcy restructuring—filing fees, costs associated with compliance and reporting requirements, attorney's fees, and costs associated with appearing in court—can be excessive); see also Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding Pennzoil v. Texaco*, 75 VA. L. REV. 295, 299 (1989) (arguing that "the process of reorganization, especially if protracted, can destroy value"); Charles J. Tabb, *The Future of Chapter 11*, 44 S.C. L. REV. 791, 799–800 (1993) (discussing multiple studies regarding the large costs of Chapter 11).

31. See W. HOMER DRAKE JR. & CHRISTOPHER S. STRICKLAND, CHAPTER 11 REORGANIZATIONS § 12:3 (2d ed. 2011) (providing a general overview of how prepackaged plans work generally); Gebbia-Pinetti, *supra* note 29, at 184 ("[B]oth the National Bankruptcy Review Commission and the National Bankruptcy Conference have formally recommended that efforts be made to reduce unnecessary costs and delay in Chapter 11 restructurings by facilitating and expediting pre-packaged Chapter 11 reorganization cases.").

32. See Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 250–51 (1987) (discussing the legislative history of the Act and noting that both Congress and the SEC knew that this holdout problem could frustrate some out-of-court workouts).

the bondholder.³³ Accordingly, an individual creditor may have significant influence over the extent and success of a company's out-of-court restructuring efforts.

An out-of-court restructuring may take a variety of forms. A company may attempt to exchange its existing debt for either new notes with more favorable repayment terms or common stock in order to reduce the company's overall leverage.³⁴ It may engage in a program of asset disposal within the bounds of debt covenants. It may seek a strategic partner with some financing backing. It may also use a combination of these and other recapitalization options, which include the infusion of new capital or new investors into the capital structure.³⁵ Such restructurings are not, however, free from cost. The company likely must pay significant fees, and the restructuring may require concessions regarding operations and any future restructurings.

Concessions in the face of an out-of-court restructuring may appropriately discipline management or, alternatively, unduly impede management's ability to return a company to profitability. For example, management's agreement to sell non-core assets or retain a Chief Restructuring Officer might help rightsize a business. The Chief Restructuring Officer may, however, have obligations to the creditors and encourage a company to forego projects that do not align with the creditors' investment horizons or the interests of other constituents.³⁶

33. 15 U.S.C. §§ 77aaa, 77ppp(b) (2006); *see also* George W. Shuster, Jr., *The Trust Indenture Act and International Debt Restructurings*, 14 AM. BANKR. INST. L. REV. 431, 436–37 (2006) (discussing how 316(b) “provides contractually preemptive protection” “to one bondholder against other bondholders” “for payment of principal and interest when due”).

34. *See, e.g., Saybrook Successfully Completes the Out-of Court Restructuring of Foster Wheeler, Ltd.*, BUSINESSWIRE (Nov. 4, 2004, 6:05 AM), <http://www.businesswire.com/news/home/20041104005211/en/Saybrook-Successfully-Completes-Out-of-Court-Restructuring-Foster-Wheeler>; Jennifer Weitzman, *J. Crew Downgraded by Standard & Poor's*, WOMEN'S WEAR DAILY (Apr. 15, 2003), <http://www.wwd.com/fashion-news/fashion-features/j-crew-downgraded-by-standard-poor-8217-s-734165> (subscription required); Continental Global Group, Inc., Current Report (Form 8-K) (July 23, 2004), *available at* <http://www.sec.gov/Archives/edgar/data/24008/000095015204005565/108789ae8vk.txt>; *see also* Gina Gutzeit & John Yozzo, *Distressed Debt Exchanges: You Can Run, but You Can't Hide*, AM. BANKR. INST. J., Mar. 2010, at 46, 46 (discussing how distressed debt exchanges, where a troubled borrower offers a creditor different securities in exchange for the debt claim, increased dramatically in 2009). *See generally* Edward I. Altman & Brenda Karlin, *The Re-Emergence of Distressed Exchanges in Corporate Restructuring*, 5 J. CREDIT RISK, Summer 2009, at 43, *available at* http://www.risk.net/digital_assets/4519/v5n2a3.pdf (discussing the re-emergence of distressed exchange as a restructuring mechanism).

35. *See, e.g.,* Dan Trigoboff, *XM Radio Gets \$450M Infusion*, BROADCASTING & CABLE (Dec. 29, 2002), http://www.broadcastingcable.com/article/145257-XM_Radio_Gets_450M_Infusion.php.

36. *See* John Wm. Butler, Jr., Chris L. Dickerson & Stephen S. Neuman, *Preserving State Corporate Governance Law in Chapter 11: Maximizing Value Through Traditional Fiduciaries*, 18 AM. BANKR. INST. L. REV. 337, 356 (2010) (noting that while some experts believe

Similarly, restrictive covenants and creditor veto rights in the restructuring documents may hinder future operations.³⁷ For these reasons, management must tread carefully through the out-of-court restructuring negotiations.

In this vein, management's openness to a Chapter 11 bankruptcy process might hold value in restructuring discussions. Management's ability to explain creditors' rights in, and the landscape of, any Chapter 11 case for the company allows all parties to appreciate the choices at hand and may provide management with leverage in negotiations.³⁸ Nevertheless, this approach also requires management to confront both its own failings and the possibility that management might have to air those failings in a very public forum—a thought often repugnant to management. Consequently, the Chapter 11 option often enters the discussion, if at all, too late in the process.

2. Bankruptcy Restructurings

A distressed company may file a Chapter 7 liquidation case or a Chapter 11 reorganization case under the Bankruptcy Code. In a Chapter 7 case, a bankruptcy trustee replaces the company's management and works to sell the company's assets to repay its creditors.³⁹ In a Chapter 11 case, the company's management generally stays in control of the company and its reorganization efforts;⁴⁰ the company operates as a "debtor-in-possession" with essentially the same

independent, third-party chief restructuring officers can prove beneficial, the use of CROs raises serious conflict of interest issues because CROs can be "predisposed to favor only one entity involved in the debtor's chapter 11 reorganization: the creditor who was responsible for getting them hired").

37. See, e.g., Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 198 (2004) (discussing the expanding power of secured creditors in the Chapter 11 process, which is due in part to credit facilities' use of restrictive covenants and rights of control provisions); Martin J. Whitman, Stanley J. Garstka & Myron M. Sheinfeld, *A Rejoinder to "The Untenable Case for Chapter 11,"* 2 J. BANKR. L. & PRAC. 839, 856–57 (1993) (discussing restrictive covenants such as cash sweeps and prohibitions on future borrowing that can impair the reorganization process).

38. See, e.g., John C. DiDonato & Daniel P. Wikel, *Managing Traditional Chapter 11 Reorganizations: A Primer for Directors and Officers on Bankruptcy Fundamentals*, in NAVIGATING TODAY'S ENVIRONMENT: THE DIRECTORS' AND OFFICERS' GUIDE TO RESTRUCTURING 214, 214 (John Wm. Butler, Jr. ed., 2010) ("Sometimes the best weapon, and strongest negotiation tactic with creditor constituents, is to play the 'bankruptcy card'. Most parties are aware that filing for protection affords companies 'time out' from their creditors and the precious time to regroup.").

39. See generally 11 U.S.C. §§ 701–727 (2006) (showing general Chapter 7 provisions of Bankruptcy Code); *id.* §§ 701–704 (discussing the selection of a trustee and duties of a trustee).

40. See generally 11 U.S.C. §§ 1101–1146 (2006) (showing general Chapter 11 provisions of Bankruptcy Code).

rights, duties, and powers as a bankruptcy trustee.⁴¹ A company can sell some or all of its assets in a Chapter 11 case,⁴² and creditors can request the appointment of a Chapter 11 trustee or examiner.⁴³ Notably, the actual appointment of a Chapter 11 trustee is the exception rather than the rule.⁴⁴

Not surprisingly, when bankruptcy is necessary, most companies prefer to file Chapter 11 cases. As noted above, in Chapter 11 cases the company—through its management—stays in control of the process and continues to operate its business. In addition, the Bankruptcy Code offers management a number of useful restructuring tools. For example, the bankruptcy filing triggers an automatic stay, which prevents parties from prepetition actions and the collection of prepetition debts against the company. The debtor retains the unilateral ability to decide whether to keep or reject most types of contracts and leases, and has a significant period of time to make this decision. The debtor may sell some or all of its assets free and clear of most claims, liens, and encumbrances. It also has an initial exclusive period to file a proposed plan of reorganization. Moreover, the Bankruptcy Code gives the debtor assistance in the negotiation and structure of post-petition financing.

Nevertheless, management of a distressed company may have operational and reputational concerns that relate to a Chapter 11 filing. Although some originally characterized the amendments as creating a pro-debtor forum,⁴⁵ amendments to the Bankruptcy Code reallocate

41. *Id.* § 1107 (discussing the rights, powers, and duties of a company as a debtor-in-possession).

42. *Id.* § 363 (permitting sales of a debtor's assets in the ordinary course of business or, with prior notice and approval, outside of the ordinary course of business); see also Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 673–74 (2003) (discussing how the asset sales in Chapter 11 today are inconsistent with past conceptions of bankruptcy reorganization); Ali M.M. Mojdehi & Janet Dean Gertz, *The Implicit "Good Faith" Requirement in Chapter 11 Liquidations: A Rule in Search of a Rationale?*, 14 AM. BANKR. INST. L. REV. 143, 152–53 (2006) (discussing history, scholarship, and case law in regard to companies using Chapter 11 to liquidate and sell assets rather than to reorganize and re-emerge).

43. 11 U.S.C. § 1104 (discussing appointment of a trustee or examiner); see also Kelli A. Alces, *Enforcing Corporate Fiduciary Duties in Bankruptcy*, 56 U. KAN. L. REV. 83, 83 (2007) (commenting that the "conventional wisdom . . . that Chapter 11 trustees should almost never be appointed . . . is wrong"); Stuart C. Gilson & Michael R. Vetsuypens, *Creditor Control in Financially Distressed Firms: Empirical Evidence*, 72 WASH. U. L.Q. 1005, 1012 (1994) (discussing creditors threatening to petition the court to appoint a trustee if managers do not resign); Jonathan C. Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L.J. 1, 2 (2010) (defining the role of examiners and Congress's reasoning for creating them).

44. See Alces, *supra* note 43, at 84 (noting that companies rarely pursue the appointment of a trustee in bankruptcy); Lipson, *supra* note 43, at 50 (noting that while examiners are more likely to appear in larger cases, they are still rare—even among larger cases).

45. See, e.g., Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 1), 57 AM. BANKR. L.J. 99, 101 (1983) (noting that

power in many Chapter 11 cases to allow prepetition lenders, landlords, counterparties, and other constituencies to significantly influence the process.⁴⁶ For example, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) shortened a debtor's exclusive period to file a reorganization plan and limited the types of retention and severance benefits available to a debtor's top management.⁴⁷ BAPCPA also truncated the debtor's time to assume or reject commercial real estate leases and elevated the priority of a vendor's reclamation claims against the debtor.⁴⁸ In addition, various amendments broaden the protections afforded counterparties under certain types of derivatives and financial contracts with a debtor, all of which potentially cause a debtor to lose significant value on the first day of a bankruptcy case.⁴⁹

The constant power struggle with Chapter 11—played out in amendments to the Bankruptcy Code and in bankruptcy courts throughout the United States—is counterproductive to the common goals of the debtor and all of its constituencies, i.e., maximization of value and rehabilitation of viable businesses. Neither a pro-debtor nor a pro-creditor system achieves an optimal result.⁵⁰ As such, the current

debtor companies were generally “successful in dictating the terms of reorganization to their creditors”); Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 2), 57 AM. BANKR. L.J. 247, 247–48 (1983) (noting that creditors historically took little interest in bankruptcy proceedings because the bankruptcy legislation did not “provide the means for them to exercise meaningful control or to make their participation profitable”). See generally DAVID A. SKEEL, JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 212–32 (2001) (explaining historical aspects of the perception that bankruptcy laws favored debtors).

46. See Baird & Rasmussen, *supra* note 42, at 675 (describing creditor control as the dominant theme in modern Chapter 11 cases).

47. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.); see 11 U.S.C. §§ 503(c), 1121(d) (2006).

48. See Robert N.H. Christmas, *Designation Rights—A New, Post-BAPCPA World*, AM. BANKR. INST. J., Feb. 2006, at 10, 10 (noting the new timing limitation will dramatically affect debtors); David L. Woods, *Reclamation Under BAPCPA: Model for Uniformity?*, AM. BANKR. INST. J., July/Aug. 2007, at 40, 40 (discussing how the BAPCPA provisions expanded the ability of a seller to reclaim goods from an insolvent buyer).

49. Rhett G. Campbell, *Financial Markets Contracts and BAPCPA*, 79 AM. BANKR. L.J. 697, 712 (2005) (describing how Congress concluded “that expanded [protections for counterparties, etc] will promote the stability of worldwide capital markets and that this public good (reducing systemic risk) justifies preserving less value for creditors in a single bankruptcy proceeding”); Edward R. Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankrupt Debtors and Bankruptcy Judges*, 13 AM. BANKR. INST. L. REV. 641, 641 (2005) (discussing amendments to the Bankruptcy Code, which “now protect[] any counterparty to any derivatives contract”); Michael H. Weiss, *Using Derivatives to Create Bankruptcy Proof Loans*, 30 CAL. BANKR. J. 207, 268 (2010) (describing how BAPCPA effectively removes large numbers of transactions from the bankruptcy process, which is historically designed to treat creditors in an orderly and fair manner).

50. See, e.g., 1 BANKRUPTCY: THE NEXT TWENTY YEARS: NATIONAL BANKRUPTCY REVIEW

power balance that arguably favors various creditor constituencies often causes distressed companies to either forego Chapter 11 or delay any Chapter 11 filing to their detriment. Anecdotal and empirical data suggest that management fears loss of control and loss of valuable contract rights.⁵¹

A distressed company's management also may fear losing face. Once a company files for Chapter 11 bankruptcy, it basically operates inside a public fishbowl.⁵² The company must disclose extensive information that concerns its prepetition and current operations and obligations. Various parties, which include a statutory committee of unsecured creditors, have rights to review and investigate management activities.⁵³ Empirical studies also document a high turnover in top management of bankrupt companies, which may cause some managers to worry about job security if they discuss bankruptcy options.⁵⁴ Moreover, bankruptcy often carries the stigma of failure and is a very public recognition of a management's deficiencies.⁵⁵

On balance, in the current legislative environment, management of a distressed company may be reluctant to consider bankruptcy as a viable restructuring option. If management ignores this option, however, out-

COMMISSION FINAL REPORT, at i (1997) ("A bankruptcy system that does not balance the interests of creditors and the interests of debtors will have neither their confidence nor, of even greater importance, the confidence of the American people.").

51. See *infra* Part II; see also A. Mechele Dickerson, *The Many Faces of Chapter 11: A Reply to Professor Baird*, 12 AM. BANKR. INST. L. REV. 109, 133–34 (2004) (discussing how managers of insolvent or nearly insolvent firms make biased decisions and also experience fear that they are about to lose their job).

52. Brad B. Erens & Kelly M. Neff, *Confidentiality in Chapter 11*, 22 EMORY BANKR. DEV. J. 47, 48 (2005) (describing how bankruptcy court filings are publicly available and how displaying proceedings in a public forum often is not in the best interest of the company or its creditors).

53. See, e.g., FED. R. BANKR. P. 2015(a)(1)–(5) (providing that the debtor-in-possession (DIP) or trustee must: file and transmit a report containing a complete inventory of the property of the debtor; "keep a record of receipts and the disposition of money and property received"; file reports and summaries statutorily required, which must include additional information if payments are made to employees; and provide quarterly reports that regard any disbursements and any fees payable for that quarter); *id.* 2015.3(a) (providing that the DIP or trustee must "file periodic financial reports of the value, operations, and profitability of each entity that is not a publicly traded corporation or a debtor in a case under title 11, and in which the estate holds a substantial or controlling interest"); 11 U.S.C. § 308 (2006) (discussing the reporting requirements applicable to small business cases).

54. See Dickerson, *supra* note 51, at 132 n.110, 134; see also Ramesh K.S. Rao, David Simon Sokolow & Derek White, *Fiduciary Duty a la Lyonnais: An Economic Perspective on Corporate Governance in a Financially-Distressed Firm*, 22 J. CORP. L. 53, 67 (1996) (citing to empirical studies by Stuart Gilson, Lynn LoPucki, and their colleagues, regarding high turnover amongst management and directors prior to and during bankruptcy).

55. See, e.g., Dickerson, *supra* note 51, at 134 (noting that directors of insolvent firms take into account the anticipated reputational harm and public scrutiny they may face if or when the company files for bankruptcy).

of-court restructurings may weaken management's position and inhibit hybrid restructuring efforts, such as a prepackaged plan of reorganization.⁵⁶ A company must be willing to consider bankruptcy, however, in order to assess the utility of any hybrid restructuring plan.

3. Prepackaged Restructurings

A prepackaged plan of reorganization, which is similar to most hybrid restructuring tools, typically involves a private restructuring arrangement the company implements through a judicial process.⁵⁷ It has the potential to mitigate some of the concerns critics frequently voice about a full-blown Chapter 11 case.⁵⁸ It is not a restructuring option, however, for every distressed company, and its current structure confines the types of distress the process successfully resolves.

For the most part, non-bankruptcy law governs prepackaged plans that represent a privately negotiated contract solution to a company's distress.⁵⁹ This aspect of the process subjects it to several of the limitations discussed above in the context of pure out-of-court workouts. For example, the company does not receive the benefit of an automatic stay, and it may find it difficult to identify and bring to the negotiating table the necessary parties.⁶⁰ Prepackaged plans also usually apply only to the resolution of bank and funded debt claims because of both collective action problems and challenges from representing unsecured creditors, vendors, employees, and shareholders at the negotiating table.⁶¹ This may expose the company to ongoing vulnerability, either because of the company's failure to truly deleverage the balance sheet or because of the new burdens the only constituencies at the table—typically banks and bondholders—impose.⁶²

56. JOSE M. GARRIDO, A WORLD BANK STUDY: OUT-OF-COURT DEBT RESTRUCTURING 48–49 (2012).

57. *Id.* at 49.

58. See Duberstein, *supra* note 29, at 365 (1993) (“Since the prepackaged plan is negotiated before the [C]hapter 11 case starts, it can take advantage of all the benefits available under the Code without the detriments of a prolonged and expensive proceeding” (emphasis omitted) (quoting Marc S. Kirschner et al., *Prepackaged Bankruptcy Plans: The Deleveraging Tool of the '90s in the Wake of OID and Tax Concerns*, 21 SETON HALL L. REV. 643, 663 (1991))).

59. Harner, *supra* note 10, at 739.

60. See *id.* at 737–39 (“The consensual nature of an out-of-court restructuring limits its usefulness.”).

61. *Id.* at 739.

62. See, e.g., Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom,”* 54 VAND. L. REV. 231, 252 (2001) (“[C]ompanies emerging from prepackaged bankruptcies after 1990 were more likely to refile than were companies emerging from non-prepackaged cases during the same period.”).

In a pure prepackaged plan scenario, the company solicits acceptances of the proposed plan from the debtholders whose claims the plan modifies. This solicitation must comply with applicable non-bankruptcy law, which includes federal securities law, for any public securities the plan involves.⁶³ If the debtholder's acceptance of the plan comports with the requirements of the Bankruptcy Code, the company then commences a Chapter 11 case to confirm and implement the prepackaged plan.⁶⁴ This can be a relatively quick process.⁶⁵ If the company does not receive acceptable support for the plan, it can start the process over or commence its Chapter 11 case as a prearranged plan case. In the prearranged plan scenario, the company may refine the prepetition plan and solicit acceptances of the plan again through the formal solicitation and confirmation procedures under the Bankruptcy Code.⁶⁶

Both prepackaged and prearranged plans are alternatives to a long, contentious bankruptcy case, but they are only two of a distressed company's options and, as currently structured, provide only limited relief. Moreover, if a company is unwilling to discuss bankruptcy-related tools, it may discount or ignore any hybrid restructuring options. The challenge, then, is to foster with management a meaningful dialogue that concerns the company's distress and that accounts for all of its restructuring options at a time that still permits full exploitation of those options. The next section of this Article discusses the heuristics and cognitive biases that can potentially confound this discussion.

B. *Heuristics and Bias in Decision-Making*

Business decisions are complex, time-sensitive, and, in the distressed context, almost always subject to controversy.⁶⁷ Even the most skilled

63. Harner, *supra* note 10, at 739.

64. *Id.* at 739–40.

65. According to BankruptcyData.com, one of the quickest prenegotiated or prepackaged bankruptcies since 2009 was for Baseline Oil & Gas Corp., which was filed August 28, 2009 and was confirmed twenty-eight days later. Douglas M. Foley & James E. Van Horn, *Prepacks on the Rise in Chapter 11 Bankruptcies: Prenegotiated Plans Can Accelerate Reorganization, TURNAROUND MGMT. ASS'N* (Aug. 27, 2008), <http://www.turnaround.org/Publications/Articles.aspx?objectID=9655>; see also *In re Baseline Oil & Gas Corp.*, No. 09-36291, 2009 Bankr. LEXIS 5453, at *1–2 (Bankr. S.D. Tex. Sept. 25, 2009).

66. Harner, *supra* note 10, at 740–41.

67. See *GPC XLI, L.L.C. v. Loral Space & Commc'ns, Inc.*, Nos. 2808-VCS, 3022-VCS, 2008 WL 4293781, at *1–2, *4, *12 (Del. Ch. Sept. 19, 2008) (involving a group of minority shareholders who, after the company emerged from Chapter 11, brought a derivative action on behalf of the corporation against the dominant shareholder (a company “whose business model involved taking control of distressed companies and positioning itself to reap the benefits of control for itself and its investors”) and its directors and alleged unfairness in connection with a complex post-bankruptcy financing transaction); see, e.g., Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV.

executives need input and support to make these decisions. Many executives find this support in their colleagues and professional advisers.⁶⁸ The value of that support to the company, however, may turn on the decision maker's own heuristics and cognitive biases.⁶⁹

1. Examples of Heuristics and Biases

Heuristics are mental shortcuts individuals use to facilitate quick and decisive action, often at the expense of ignoring relevant information.⁷⁰ These shortcuts—also referred to as “decision-making strategies”—rely on factors easily accessible by the decision-maker, such as prior experiences (e.g., representative heuristics) and emotions (e.g., confirmation, overconfidence, and loss-aversion biases).⁷¹ Corporate managers may invoke any number of these mental strategies to respond with the speed and efficacy that stakeholders and markets demand.⁷² A

1209, 1236–37 (2006); David A. Skeel, Jr., *Creditors' Ball: The “New” New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 918 (2003). See generally *Loral Stockholders Protective Comm. v. Loral Space & Commc'ns, Ltd.*, 342 B.R. 132 (S.D.N.Y. 2006). When a company experiences financial distress, a number of different constituencies, which include lenders, may place pressure on management. Moreover, at least one commentator suggests that this pressure and influence exists even outside of the distressed context. See Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 120 (2009) (“Lender influence is pervasive. Empirical research documents the regularity with which banks constrain fundamental managerial decisions even in the ordinary course of business.”).

68. See, e.g., CORP. LAWS COMM., ABA SECTION OF BUS. LAW, *Corporate Director's Guidebook—Sixth Edition*, 66 BUS. LAW. 975, 989 (2011) (discussing the board's options for staying informed and finding support).

69. For a general discussion of heuristics and biases, see BEHAVIORAL LAW AND ECONOMICS 59–208 (Cass R. Sunstein ed., 2000); Inga Chira, Michael Adams & Barry Thornton, *Behavioral Bias Within the Decision Making Process*, 6 J. BUS. & ECON. RES., Aug. 2008, at 11, 11 (“[Behavioral finance] draws on the psychology and cognitive science literatures to examine why individual decision-making often deviates from rational choices in systematic ways.”); Langevoort, *Literature Review*, *supra* note 8, at 1501–02. See generally Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. LEGAL STUD. 747 (1990) (discussing the implications of cognitive psychology in high-risk decision-making).

70. See Gerd Gigerenzer & Wolfgang Gaissmaier, *Heuristic Decision Making*, 62 ANN. REV. PSYCHOL. 451, 454 (2011) (“A heuristic is a strategy that ignores part of the information, with the goal of making decisions more quickly, frugally, and/or accurately than more complex methods.”).

71. See Eyal Ert & Ido Erev, *The Rejection of Attractive Gambles, Loss Aversion, and the Lemon Avoidance Heuristic*, 29 J. ECON. PSYCHOL. 715, 721 (2008) (discussing loss aversion bias in heuristic decision-making); Cass R. Sunstein, *Hazardous Heuristics*, 70 U. CHI. L. REV. 751, 766 (2003) (discussing the use of prior experience in heuristic decision-making); Larissa Z. Tiedens & Susan Linton, *Judgment Under Emotional Certainty and Uncertainty: The Effects of Specific Emotions on Information Processing*, 81 J. PERSONALITY & SOC. PSYCHOL. 973, 973 (2001) (discussing emotions and moods in heuristic decision-making).

72. Jaana Woiceshyn, *Lessons from “Good Minds”: How CEOs Use Intuition, Analysis*

few strategies are particularly relevant in the context of distressed companies.

The representative heuristic refers to individuals who draw upon past experiences and “perceived similarity to a particular known group or event” when they make decisions in the face of uncertainty.⁷³ This heuristic can prove useful and can help managers avoid paralysis in difficult decisions. It also, however, can create false assumptions that cause errors in judgment.⁷⁴ For example, a CEO or director who knows of colleagues who have lost their jobs or suffered reputational damage when their companies filed for bankruptcy might factor that into her decision. Likewise, she might reference the frequently negative media coverage of companies that file Chapter 11 cases, such as headlines reading, *With A123’s Bankruptcy, America’s Battery Biz Goes Dead*, and *Ding Dong, Are Twinkies Dead?*⁷⁵ These representations likely will taint her assessment and conclusions regarding the appropriate path for her distressed company.

Not only might a manager discount a bankruptcy or restructuring alternative based on a representative heuristic, but a manager also might honestly believe that she is exceptionally skilled and can turn around her

and Guiding Principles to Make Strategic Decisions, 42 LONG RANGE PLANNING 298, 299 (2009) (“Studies have found systematic, rational analysis insufficient to deal effectively with complexity. The overall conclusion of the research so far is that experienced decision makers . . . rely on intuition to supplement, or at times even to substitute for, rational analysis. . . . Studies suggest that many corporate executives use more intuition than formal analysis in making decisions.”); T.K. Das & Bing-Sheng Teng, *Cognitive Biases and Strategic Decision Processes: An Integrative Perspective*, 36 J. MGMT. STUD. 757, 773 (1999) (noting that “[h]euristics and biases are often valuable and indispensable for effective decision making. This may be particularly relevant for strategic decisions”). But see *id.* at 760 (describing potential negative consequences of heuristics on strategic decision-making).

73. Mark R. Kebbell, Damon A. Muller & Kirsty Martin, *Understanding and Managing Bias*, in DEALING WITH UNCERTAINTIES IN POLICING SERIOUS CRIME 87, 89 (Gabriele Bammer ed., 2010). See generally Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCI. 1124 (1974) (discussing generally cognitive biases in decision-making).

74. See Das & Teng, *supra* note 72, at 760 (“Although these ‘rules of thumb’ are often necessary and useful, they also introduce cognitive biases that can lead to severe and systematic errors in decision making.” (citation omitted)); Sunstein, *supra* note 71, at 766–67, 775 (noting how emotions and overconfidence can negatively interfere with decision-making); Tversky & Kahneman, *supra* note 73, at 1124 (“In general, these heuristics are quite useful, but sometimes they lead to severe and systematic errors.”).

75. Michael V. Copeland, *With A123’s Bankruptcy, America’s Battery Biz Goes Dead*, WIRED.COM (Oct. 16, 2012, 6:18 PM), <http://www.wired.com/business/2012/10/a123-bankruptcy>; *Ding Dong, Are Twinkies Dead?*, CHARLESTON GAZETTE (Nov. 16, 2012), <http://wvgazette.com/News/Business/201211160143>; see also Tiffany Kary & Linda Sandler, *Borders Files Bankruptcy, Is Closing Up to 275 Stores*, BLOOMBERG.COM (Feb. 16, 2011, 12:12 PM), <http://www.bloomberg.com/news/2011-02-16/borders-book-chain-files-for-bankruptcy-protection-with-1-29-billion-debt.html>.

company where others could not. Such an overconfidence bias distorts a decision maker's assessment of her ability to achieve the desired goal. Those affected by an overconfidence bias "overestimate their abilities, believe that they know more than they in fact do, and suffer from an 'illusion of control,' believing that they exert more control over results than they actually do."⁷⁶ Commentators consider potential issues with CEO overconfidence in the context of mergers and acquisitions, investment decisions, risk assessment, and corporate governance generally.⁷⁷ These issues, which include overestimation of the value of projects and the likelihood of positive outcomes, apply in the context of distressed companies as well. Indeed, a distressed company may experience more significant negative consequences because of the CEO's unfounded belief that the distress is temporary or that she can help the company overcome the downturn.⁷⁸

In theory, other managers and directors should serve as a check to counter any representative heuristic or overconfidence bias that impairs a CEO or manager's decision-making. In practice, however, an optimism bias may limit the effectiveness of this check. Individuals who work with the decision-maker may fear that if they dissent to a proposed course of action they will appear either as disloyal or as an outlier. As Professors Dan Lovallo and Daniel Kahneman explain:

Organizations also actively discourage pessimism, which is often interpreted as disloyalty. The bearers of bad news tend to become pariahs, shunned and ignored by other employees. When pessimistic opinions are suppressed, while optimistic ones are rewarded, an organization's ability to think critically is undermined. The optimistic biases of individual employees become mutually reinforcing, and unrealistic views of the future are validated by the group.⁷⁹

76. Troy A. Paredes, *Too Much Pay, Too Much Deference: Behavioral Corporate Finance, CEOs, and Corporate Governance*, 32 FLA. ST. U. L. REV. 673, 689 (2005).

77. See *id.* (arguing that corporations should adjust corporate governance to manage CEO overconfidence); see also Bernard S. Black, *Bidder Overpayment in Takeovers*, 41 STAN. L. REV. 597, 624–25 (1989) (discussing optimism and overpayment in corporate takeovers); Ulrike Malmendier & Geoffrey Tate, *Who Makes Acquisitions? CEO Overconfidence and the Market's Reaction*, 89 J. FIN. ECON. 20, 42 (2008) (studying confidence in CEOs for M&A transactions and financial investment decisions); Richard Roll, *The Hubris Hypothesis of Corporate Takeovers*, 59 J. BUS. 197, 200 (1986) (discussing overconfidence, or "hubris," in the context of mergers and acquisitions).

78. See *infra* Subsection II.C.4; see also Michelle M. Harner, *Barriers to Effective Risk Management*, 40 SETON HALL L. REV. 1323, 1354 (2010) (discussing how CEOs and executives "overestimate their own abilities" and "believe that they are the exception to the rule").

79. Lovallo & Kahneman, *supra* note 9, at 60–61.

Accordingly, management may talk each other into a frenzy of agreement on an ill-fated course of action. Moreover, management may draw on the support of colleagues and the negative perception of bankruptcy to confirm the substance of their decision and thereby introduce a confirmation bias into the equation.⁸⁰

A fellow manager or director is not the only individual who can enable or validate a decision maker's errors in judgment. Professionals (lawyers, financial advisers, and accountants) who advise corporate management also can play such a role in a variety of ways. For example, an adviser may provide information that suggests certain advantages to the decision maker's proposed action. Even if the adviser also explains the disadvantages, the decision-maker likely will latch on to the positive aspects to confirm her belief. Advisers may soften their advice to please the client and contribute to an optimism bias. Advisers, by their words, tone, and phrasing, also may frame issues in a manner that affects a client's decision-making process.⁸¹

2. The Framing Bias and Restructurings

Studies show that the way a person frames or communicates an issue affects how others perceive the problem.⁸² The following data from the

80. In addition, a related bias—commitment bias—may prevent management from changing their decision even after the error in judgment is recognized. *See, e.g.,* IRVING L. JANIS & LEON MANN, *DECISION MAKING: A PSYCHOLOGICAL ANALYSIS OF CONFLICT, CHOICE, AND COMMITMENT* 15 (1977).

81. *See* Katherina Glac, *Understanding Socially Responsible Investing: The Effect of Decision Frames and Trade-Off Options*, 87 J. BUS. ETHICS 41, 43–44 (2008) (describing the operation of framing bias in a clear and relatively detailed manner); Richard W. Painter, *Convergence and Competition in Rules Governing Lawyers and Auditors*, 29 J. CORP. L. 397, 404 (2004) (discussing framing bias in the corporate context); Jeffrey J. Rachlinski, *Gains, Losses, and the Psychology of Litigation*, 70 S. CAL. L. REV. 113, 122–23 (1996) (explaining framing bias generally); Robert B. Thompson, *Securities Regulation in an Electronic Age: The Impact of Cognitive Psychology*, 75 WASH. U. L.Q. 779, 784 (1997) (explaining framing bias in investment decisions); X.T. Wang, *Framing Effects: Dynamics and Task Domains*, 68 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 145, 146 (1996) (discussing framing bias generally).

82. *See* Weinstein, *supra* note 14, at 797 (2003); *see also* William A. Boettcher III, *Military Intervention Decisions Regarding Humanitarian Crises: Framing Induced Risk Behavior*, 48 J. CONFLICT RESOL. 331, 349 (2004) (discussing a study of how framing affects public opinion on U.S. military intervention in humanitarian crises); Michael J. Hiscox, *Through a Glass and Darkly: Attitudes Toward International Trade and the Curious Effects of Issue Framing*, 60 INT'L ORG. 755, 777–78 (2006) (reporting findings from a study aimed at measuring the impact of issue framing on individuals' attitudes in regard to international trade). *See generally* Theresa M. Marteau, *Framing of Information: Its Influence Upon Decisions of Doctors and Patients*, 28 BRIT. J. SOC. PSYCHOL. 89 (1989) (discussing a study of doctor and patient decision-making for certain medical treatments and how the presentation of options and probabilities influences those decisions).

work of Professors Amos Tversky and Daniel Kahneman illustrate a framing bias:

Imagine that the United States is preparing for the outbreak of an unusual Asian disease, which is expected to kill 600 people. Two alternative programs to combat the disease have been proposed. Assume that the exact scientific estimates of the consequences of the programs are as follows:

If Program A is adopted, 200 people will be saved

If Program B is adopted, there is a one-third probability that 600 people will be saved and a two-thirds probability that no people will be saved

In this version of the problem, a substantial majority of respondents favor Program A, indicating risk aversion. Other respondents, selected at random, receive a question in which the same cover story is followed by a different description of the options:

If Program A' is adopted, 400 people will die

If Program B' is adopted, there is a one-third probability that nobody will die and a two-thirds probability that 600 people will die

A substantial majority of respondents now favor Program B', the risk-seeking option.⁸³

Many commentators suggest that phrasing issues in terms of certain losses (a loss frame) produces risk-seeking conduct.⁸⁴ This effect—which prospect theory also explains—“argues that the value of gains and losses are experienced differently; for example, people are more likely to take risks in the domain of losses because of diminishing sensitivity to large losses, producing a convex portion of the value function.”⁸⁵ At least one study suggests that an individual’s desire to avoid sure losses and seek more risks when presented with a loss frame intensifies if that individual is also in a high-power position.⁸⁶ That study theorizes a link between the optimism bias, often present in

83. Daniel Kahneman, *Maps of Bounded Rationality: Psychology for Behavioral Economics*, 93 AM. ECON. REV. 1449, 1458 (2003) (quoting Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCI. 453, 453 (1981)).

84. See Rachlinski, *supra* note 81, at 119. See generally Chris Guthrie, *Prospect Theory, Risk Preference, and the Law*, 97 NW. U. L. REV. 1115 (2003) (agreeing with the general hypothesis regarding framing and presenting an overview of much of the legal literature on the subject).

85. Cameron Anderson & Adam D. Galinsky, *Power, Optimism, and Risk-Taking*, 36 EUR. J. SOC. PSYCHOL. 511, 520 (2006).

86. *Id.* at 521.

individuals who hold positions of power, and framing effects—i.e., powerful individuals take more risks when they face certain loss because they believe that they will beat the odds.⁸⁷

This effect has direct and significant application to management of distressed companies. A CEO who perceives bankruptcy as failure will likely take more risks to avoid that result and will likely believe she will succeed in her efforts. Likewise, the CEO who receives professional advice that “bankruptcy should be considered only if all other options fail” or that “bankruptcy is a last resort” likely will behave in a similar manner. Accordingly, management of distressed companies may forego or delay viable restructuring options that relate to bankruptcy in the hope that they will hit the proverbial home run.

The potential ramifications of heuristics and biases on decision-making in the distressed company context raise several important questions: Do CEOs and management really hold such negative views of Chapter 11 bankruptcy, and, if so, do professional advisers reinforce these views? Do those views affect management’s decisions for distressed companies? Does the conversation that surrounds distress and restructuring need to change?

We conducted the Management Behavior Study to explore these and related questions. The next Part describes the study and suggests a need for further research and reevaluation of how management and professionals think about and discuss restructuring alternatives.

II. ASSESSING MANAGEMENT DECISION-MAKING IN DISTRESS: THE MANAGEMENT BEHAVIOR STUDY

*We probably did take longer (to file for Chapter 11) than we should have because you never want to have that feeling of failure and you always want to fight it out.*⁸⁸

Anecdotal evidence suggests that business executives hold a negative perception of Chapter 11 bankruptcy and delay consideration of restructuring as an option, often at the expense of the company and its

87. *Id.* (“This suggests that activating high-power drove individuals to be more risk-taking, but that activating low-power did not lead individuals to be more risk averse.”); see also Ziva Kunda, *Motivated Inference: Self-Serving Generation and Evaluation of Causal Theories*, 53 J. PERSON. & SOC. PSYCHOL. 636, 646 (1987) (discussing the theory of motivated inference and presenting four studies suggesting that people “generate theories that view their own attributes as more predictive of desirable outcomes and are reluctant to believe in theories that imply that their own attributes might be related to undesirable events”).

88. Chelsea Emery, *CEOs Wait Too Long Before Filing Bankruptcy*, REUTERS (Apr. 2, 2009, 4:12 AM), <http://www.reuters.com/article/2009/04/02/us-bankruptcy-psychology-idUSTRE5310AY20090402> (quoting Joseph Vicens, chief operating officer of 1800mattress.com).

stakeholders.⁸⁹ Moreover, business bankruptcy commonly is described as “an option of last resort” in the commentary and professional advisory materials on the subject.⁹⁰ Yet no studies thoroughly analyze in any meaningful detail these factors or their impact on corporate value or successful restructurings.⁹¹ The Management Behavior Study fills that void.

As this Article more fully describes below, the Management Behavior Study offers valuable insight on key components of management’s decision-making process in the distressed context. The data include responses from over 400 restructuring professionals and uncover interesting trends in client advising and decision-making. Overall, the data suggest a need for policymakers, business executives, and professionals to reevaluate the dialogue and incentive structure that surrounds Chapter 11 business cases.

A. Methodology

The Management Behavior Study targeted individuals frequently involved in business restructurings and Chapter 11 cases—specifically, professionals such as lawyers and financial advisers who work in this realm.⁹² The primary goal of the study was to collect information from professionals regarding their experiences with and observations about client advising and management behavior in the distressed company context. We designed the study to test the following hypothesis: Management of distressed companies often deny the extent of their companies’ distress and delay discussions of a Chapter 11 bankruptcy filing.

We used a database of professionals, which the American Bankruptcy Institute maintains, to structure the sample population.⁹³ The database

89. Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping by Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1397 (2000) (“[M]anagers will seek to preserve their control of the firm despite the costs to investors, even if they only are able to delay their own day of reckoning by a few months.”).

90. See DiDonato & Wikel, *supra* note 38, at 1 (discussing the tendency of directors to “exhaust ‘out of court’ restructuring options such as asset or business sales, amending their credit facilities and seeking replacement or bridging capital to improve the company’s liquidity position and ‘weather the storm’”); Ian Mount, *Adviser to Businesses Laments Changes to Bankruptcy Law*, N.Y. TIMES, Feb. 29, 2012, at B9 (stating that Chapter 11 is “an absolute last resort”).

91. For a thoughtful survey of empirical literature concerned with Chapter 11 bankruptcies, see generally Senbet & Wang, *supra* note 24, at 27–47.

92. The survey specifically asked respondents to identify their typical role in restructuring matters. See *infra* Section II.C. We did not exclude individuals based on the identity of their typical clients. Rather, we sought to capture both the company and stakeholder perspectives on the process because they recognized that professionals who primarily represented stakeholders might have a limited or different perspective on certain questions.

93. The American Bankruptcy Institute (ABI) “is the largest multi-disciplinary, non-

contained 2,296 individuals. We reviewed the database and identified a sample frame of 2,181 individuals.⁹⁴ We then drew a random sample of 1,200 individuals. After we identified ineligible respondents, we invited 1,160 individuals to participate.⁹⁵ The data collection schedule included an initial email request (sent September 24, 2012), two reminder email requests (sent October 1 and October 22, 2012), one reminder letter (mailed October 12, 2012), and one clarification email (sent October 22, 2012). We received 453 responses to the study for a valid response rate of 39.1%.⁹⁶

B. Study Design

We designed a survey tool to facilitate the Management Behavior Study. The survey included twenty questions carefully crafted to elicit non-privileged information concerning professionals' experiences with management of distressed companies.⁹⁷ The majority of the questions used objective choices, with the opportunity for respondents to explain certain responses in a narrative format. The survey was web based and included programmed skip patterns to minimize respondent error.

The core questions in the survey focused on the concept of bankruptcy as "an option of last resort" and management's reaction to that concept and their companies' distress generally. The survey also asked for information about the timing of bankruptcy filings and the key drivers behind that decision. In addition, it collected information on respondents' respective industries and extent of experience in restructuring matters. A copy of the survey is annexed at Appendix A.

partisan organization dedicated to research and education on matters related to insolvency." *About ABI*, AM. BANKR. INST., http://www.abiworld.org/AM/Template.cfm?Section=About_ABI (last visited Jan. 28, 2013). The ABI is not a sponsor of this study. The ABI's only involvement with this study was to provide us with a copy of the database. Professor Harner has, however, previously received grant funding from the ABI and is the Reporter for the ABI Commission Studying the Reform of Chapter 11.

94. One-hundred-and-fifteen individuals in the database previously opted out of communications with SurveyMonkey, the software the authors used to administer the online survey.

95. In their review of the database, we determined that certain individuals were ineligible for the study either because of their profession (e.g., they were no longer in private practice or had no recent or relevant private practice experience), potential conflicts, or had previously opted out of the web-based survey tool.

96. According to a recent meta-analysis, the average response rate for web surveys is 34%. See Tse-Hua Shih & Xitao Fan, *Comparing Response Rates from Web and Mail Surveys: A Meta-Analysis*, 20 *FIELD METHODS* 249, 257 (2008).

97. We tested the survey questions with professionals whom the database did not include and refined the questions based on those responses.

C. Key Study Data and Results

The survey data provide a glimpse into management's decision-making process based on the experiences of some professionals working with distressed companies in restructuring matters.⁹⁸ Although the data do not provide a complete picture—and the results are subject to the limitations typically applicable to this type of survey⁹⁹—they offer meaningful insights into framing effects that may influence decision-making in the context of distressed companies. In fact, the survey data acknowledge the prevalent use of loss framing by professionals in the industry and how that might impact management decisions that concern restructuring options.

1. General Types of Respondents and Their Experiences

The majority of professionals are lawyers (85.9%), though financial consultants represent approximately 12.9% of the respondents.¹⁰⁰ They work in firms of all sizes, as 44.7% work in firms that employ more than 100 lawyers, advisers, or bankers, as applicable, and 55.3% work in firms that employ 100 professionals or less. They also are a very experienced population, as 78.6% of the professionals have more than fifteen years of experience in the restructuring field.

In the majority of their restructuring matters, these professionals primarily represented distressed companies (39.0%), secured creditors (21.3%), or different parties depending on the matter (26.6%).¹⁰¹ The majority of their matters involved assets of \$100 million or less (64.8%). Approximately 12.2% of respondents indicated that the

98. Although the response rate for the survey exceeds industry averages, *see supra* note 96, it may be the case that respondents differ from nonrespondents on key statistics of interest (an empirical question to investigate in a future study).

99. Sample surveys are subject to a variety of errors that include coverage, sampling, nonresponse, and measurement. *See generally* ROBERT M. GROVES, *SURVEY ERRORS AND SURVEY COSTS* (1989) (discussing errors involved in sample surveys). To the extent that the list of professionals the American Bankruptcy Institute maintains does not represent the universe of such professionals, coverage error may be present. That is, the authors can only generalize the results to the population of professionals the sampling frame includes. Sampling error occurs in all sample surveys, by definition. For this survey, the sampling margin of error is +/- 2%. To the extent that nonrespondents to this survey differ from respondents on key variables of interest, nonresponse error may be present. Finally, to the extent that survey responses are inaccurate, measurement error may be present. *See id.* at 82–83, 133, 240, 295.

100. The data percentages this Article presents are based on valid responses; for example, 50 respondents did not answer the question that concerned profession type, so these percentages are based on 403 respondents. The footnotes identify the number of respondents who answered a particular question if the question was missing a large segment of the population. Also, the Article uses the term “financial consultant” to represent financial advisers, investment bankers, and restructuring consultants.

101. A small segment of the population represented unsecured creditors (9.4%) or equity holders (1.0%), and 2.7% designated “other” as their response.

average size of their matters involved assets of more than \$500 million.¹⁰² This allocation is similar to the general demographics of companies that file Chapter 11 cases.¹⁰³

2. What Professionals Say

The majority of professionals (63.6 %) describe bankruptcy as “an option of last resort” or use a similar phrase when they discuss restructuring options with their distressed clients.¹⁰⁴ Of those professionals who use the phrase, 39.3% use it most of the time and 41.8% use it some of the time; only 11.8% use it in all circumstances (Table 1).¹⁰⁵ The data show no significant effects based on profession type or whom the professional typically represents in distressed matters.¹⁰⁶ Nevertheless, professionals with more than fifteen years of experience are significantly more likely to use the phrase than those with fewer years of experience ($p < .001$).

102. Approximately 6% of these respondents indicated that the average size of their distressed matters involved debtors with assets of \$1 billion or more.

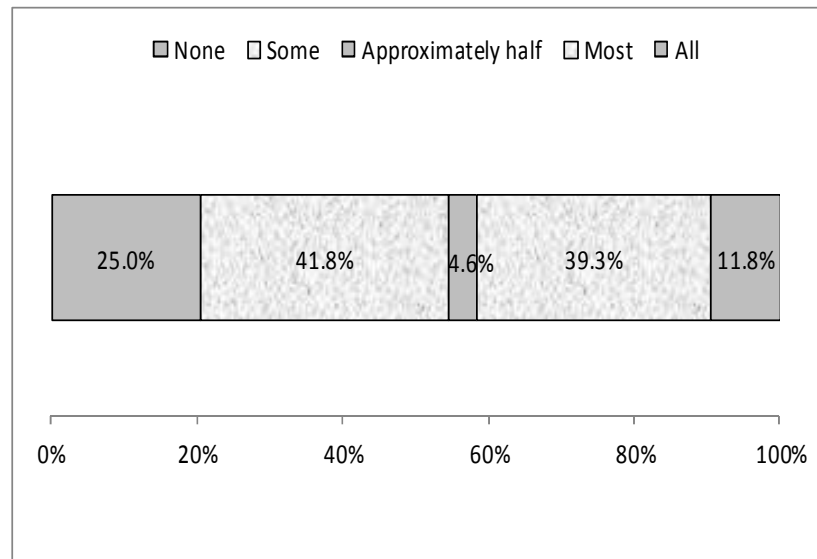
103. For data that describes the general range of Chapter 11 cases, see Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 607–10 (2009); Douglas Baird, Arturo Bris & Ning Zhu, *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study* (Yale ICF, Working Paper No. 05-29, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=866865 (discussing small and large bankruptcy case data).

104. The survey tool focused on both financial and economic distress, but it did not attempt to distinguish between the two. Specifically, it defined “distressed client(s)” as “business entity clients (both incorporated and unincorporated entities) that are experiencing or should anticipate experiencing financial distress, such as actual or potential loan defaults, liquidity issues, litigation risks, operational issues, balance sheet insolvency, or equitable insolvency.”

105. Responses were based on professionals’ experiences during the past five years.

106. Due to small subsample and cell sizes, statistical comparisons are possible among only professional types and client types on a collapsed variable (“all or most” versus “approximately half, some, or none”). Just over 50% of lawyers reported their use of such a phrase with “all or most” of their clients; similarly, 44% of financial advisers reported their use of such a phrase with “all or most” of their clients ($p = .357$). Small subsample and cell sizes permit statistical comparisons among client types such that the authors distinguished only among professionals to distressed companies or secured or unsecured creditors. The authors combined all other professionals into a fourth group. There is no significant difference in the percentage of professionals who used such a phrase with “all or most” of their clients by client type ($p = .065$). Interestingly, while only 37.3% of professionals to unsecured creditors reported such phrase usage, the majority of professionals to all other client types reported such usage (distressed companies: 53.2%; secured creditors: 65%; all others: 58.5%). The tests may prove insufficiently powered to detect a statistical difference among these groups.

Table 1. Proportion of Distressed Clients with Whom Phrase Used in Past 5 Years (n=280)

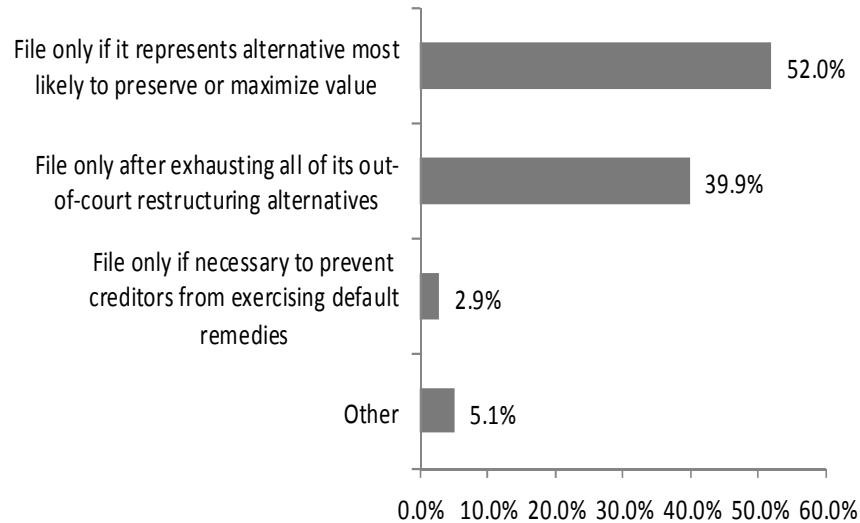


Notably not all professionals use the phrase “bankruptcy as an option of last resort” to mean the same thing. Approximately half (52%) of the respondents use the phrase to mean that the “[d]istressed client should file a bankruptcy case only if it represents the alternative most likely to preserve or maximize value.”¹⁰⁷ This use suggests that these professionals view bankruptcy as one of the many restructuring tools available to distressed clients that their clients should integrate into any meaningful restructuring discussions. Approximately 40% of the respondents, however, use the phrase to mean that the “[d]istressed client should file a bankruptcy case only after exhausting all of its out-of-court restructuring alternatives.”¹⁰⁸ This use carries a very different connotation. It arguably equates bankruptcy with complete failure.

107. *See infra* Table 2.

108. *Id.*

Table 2. Phrase Meaning (n=273)



A professional's decision to use the phrase "bankruptcy as an option of last resort"—regardless of the professional's ultimate meaning—is understandable for the variety of reasons this Article discusses above.¹⁰⁹ For example, bankruptcy can be an expensive process. In fact, the majority (52.1%) of professionals who invoke the phrase cite cost as the most common reason they describe bankruptcy in this manner.¹¹⁰ In addition, professionals cite the uncertainty of the bankruptcy process (23.2%) and the potential loss of management control (12.0%) as the most common reasons that underlie their advice.¹¹¹ Interestingly, only 3.4% of respondents indicate loss of creditor control as a motivating factor.¹¹² Although this perception may relate to the fact that many respondents represent debtors, the data also support literature that suggests a trend of less debtor, and more creditor, control in both Chapter 11 cases and in restructuring matters generally.¹¹³

109. See *supra* Section I.A.

110. See *infra* Table 3.

111. *Id.*

112. *Id.*

113. See *supra* Section I.A. In fact, several respondents commented that all response options other than "loss of creditor control" contributed to their use of the phrase "bankruptcy as an option of last resort."

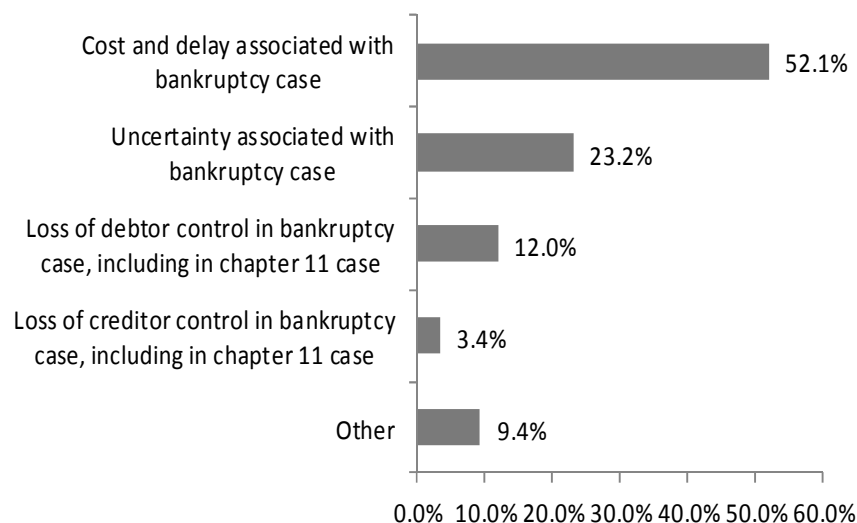


Table 3. Reason for Phrase Meaning (n=267)

A distressed company should not undertake the filing of a Chapter 11 or any bankruptcy case lightly. The process can prove expensive, lengthy, and contentious.¹¹⁴ It also can, however, balance negotiating leverage and offer restructuring options, such as the facilitation of asset sales and the management of contract portfolios, not otherwise available to the parties.¹¹⁵ Moreover, the utility of these bankruptcy-specific tools may depend on the financial state of the company when it files for bankruptcy. Accordingly, how a distressed company receives and processes a professional's advice to use "bankruptcy as an option of last resort" may significantly impact the outcome of any bankruptcy case.

3. What Clients Hear

To understand how clients might respond to the phrase "bankruptcy as an option of last resort," the survey asked several questions regarding the conduct of distressed clients in the restructuring representation. Of those professionals who used the phrase, a majority (51.6%) indicated that they have had a distressed client who refused to authorize the preparation of a bankruptcy filing at a time the professional thought appropriate.¹¹⁶ An overwhelming majority (90.0%) of those clients

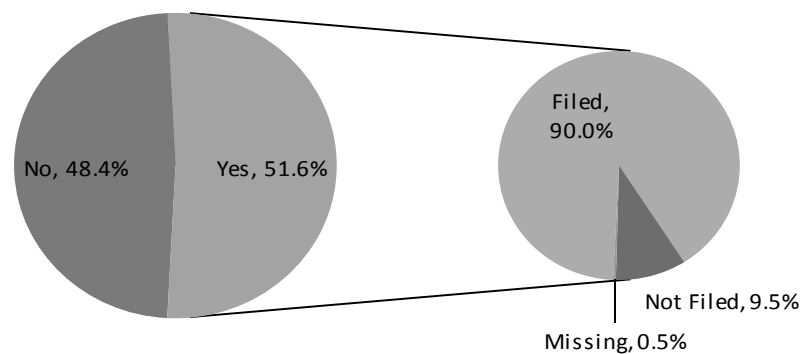
114. *See supra* Section I.A.

115. *See supra* Section I.A.

116. *See infra* Table 4. Clients appear more comfortable with professionals who discuss a

ultimately filed a bankruptcy case.¹¹⁷ These professionals indicated that approximately 36% of the clients who rejected their advice to prepare bankruptcy materials did so because they believed the company's distress was temporary or they denied the distress altogether.¹¹⁸

Table 4. Initially Refused (n=426) / (If yes) Eventual Bankruptcy Case Filing (n=220)

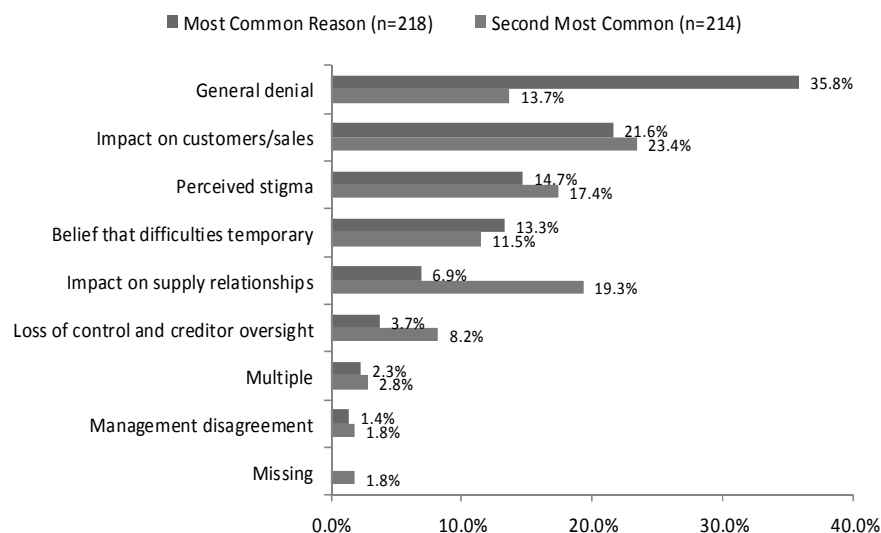


potential bankruptcy filing in the context of negotiations with creditors. Only 31% of respondents reported having a distressed client who refused to authorize the professional to discuss a bankruptcy filing in the context of negotiations. Notably these data raise several related issues. For example, some commentators may argue that professionals want to prepare a case simply because of the fees generated by such activity. SOL STEIN, A FEAST FOR LAWYERS: INSIDE CHAPTER 11—AN EXPOSE 2 (1989). Other commentators may question clients who authorize discussion of a bankruptcy filing in negotiations if the client does not intend to file such a case. Ivan J. Reich, *Managing the Insolvency of a Borrower from Both the Debtor's and Creditor's Perspective During Tough Economic Times*, ASPATORE (Apr. 2009), 2009 WL 1615228, at *11 (discussing the reputational value in making honest, not empty, "threats" regarding filing for bankruptcy). Accordingly, future studies should consider these issues.

117. See *infra* Table 4.

118. See *infra* Table 5; *infra* Appendix A, question 7. Specifically, these two responses were worded, "Belief that financial difficulties were temporary or short-term in nature," and "General denial about financial or operational obstacles facing company." The second most common reason respondents gave for clients' reluctance to authorize the preparation of bankruptcy materials was potential negative impact on sales, with 23.8% of respondents identifying that secondary factor. The potential stigma associated with bankruptcy accounted for only 14.7% of the responses regarding the most common reason distressed clients resist bankruptcy preparations.

Table 5. Reasons for Reluctance to Prepare Materials



These data suggest a moderate association between loss framing (bankruptcy as a last resort) and clients taking a high-stakes gamble (e.g., betting that operations will turn around or a white knight will save the company from its despair).¹¹⁹ In addition, the most frequently stated reason for clients' attempts to avoid bankruptcy (general denial of problems) suggests an optimism bias or belief that the company can overcome its existing financial or operational problems. These data collectively allude to some of the observations in prior studies that concern framing effects and prospect theory.¹²⁰ Nevertheless, scholars should conduct more research on these issues in the distressed context.

For example, the survey asked respondents generally about their experiences and observations from practice. Although the respondents bring a wealth of experience to the study, the data are generic in the sense that they do not document specific examples or offer evidence directly from the distressed company's perspective. Given the structure of the Management Behavior Study, such direct observations are

119. See Baird & Rasmussen, *supra* note 67, at 1227 n.54 (“[M]anagers of financially distressed firms ‘have a strong incentive to gamble with the firm’s assets.’” (quoting Barry E. Adler, *A Re-Examination of Near-Bankruptcy Investment Incentives*, 62 U. CHI. L. REV. 575, 576 (1995))); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729, 733–34 (noting that managers have similar incentives to gamble on the company’s future); David A. Skeel, Jr., *Rethinking the Line Between Corporate Law and Corporate Bankruptcy*, 72 TEX. L. REV. 471, 508 (1994) (noting that “shareholders of an insolvent company have little to lose if they gamble with the firm’s assets, [but have] much to gain”).

120. See *supra* Section I.B.

impracticable due to, among other things, concerns regarding confidentiality and the attorney–client privilege. Indeed, client-specific observations—from either the professional’s or the client’s perspective—may breach a lawyer’s duty of confidentiality or arguably waive some aspect of the attorney-client privilege on the topic.¹²¹ Accordingly, researchers should continue to explore indirect or quantitative means to document the loss or gain frames they use in the restructuring dialogue and their potential impact.¹²²

Notwithstanding these limitations, the Management Behavior Study offers insights into distressed companies’ decision-making processes that otherwise are not available. The prevalence of the use of loss framing alone is a meaningful contribution. The data permit inferences that can help policymakers question and reconsider how to legislate distress. They also can help restructuring professionals and business executives reevaluate how they approach potential restructuring options. Part III discusses these considerations.

4. Does the Dialogue Matter?

The descriptive data above explain how professionals approach the restructuring dialogue with distressed clients and how they perceive clients’ resulting behavior. Further analysis of the data shows several significant effects and trends relevant to the study’s hypothesis.

As explained above, studies suggest a correlation between loss frames and risk-seeking conduct. To identify any similar effects in the distressed company context, the survey asked respondents a variety of questions concerning their use of the phrase “bankruptcy as a last resort” and clients’ reactions to restructuring alternatives. Several interesting trends emerged.

Both respondents who used the phrase “bankruptcy as a last resort” and those who did not reported experiences with distressed clients who refused to authorize the preparation of a bankruptcy case or introduce a bankruptcy alternative into restructuring negotiations at a time the professional thought appropriate. Likewise, both groups suggested that at least some of those clients ultimately filed a bankruptcy case. Nevertheless, respondents who never used the phrase “bankruptcy as a last resort” were significantly more likely to have a client who initially refused, but ultimately did, file a bankruptcy case. Specifically, 87.2% of those who used such a phrase and 96.2% of those who never used

121. See MODEL RULES OF PROF’L CONDUCT R. 1.6 (2012); RESTATEMENT (THIRD) OF THE LAW GOVERNING LAWYERS § 79 (2000).

122. For example, researchers might design a simulation study in which participants answer hypothetical questions from the distressed company’s perspective based on realistic fact patterns developed through case studies.

such a phrase experienced a client who initially refused but ultimately filed ($p=.032$).

The data suggest that professionals who do not introduce a loss frame into their strategy discussions with distressed clients generally have clients who are more willing to ultimately file a bankruptcy case. Other data support this inference. For example, respondents who used the phrase “bankruptcy as a last resort” with all or most of their clients in the past five years were less likely to have a client who initially refused, but ultimately filed, a bankruptcy case. Specifically, 82.9% of those who used such a phrase with all or most of their clients and 92.3% of those who used such a phrase with less than most of their clients experienced a client who initially refused, but ultimately filed, a case.¹²³ Based on the survey data, clients who hear the phrase “bankruptcy as a last resort” are more likely to pursue restructuring alternatives that avoid a bankruptcy filing.

Accordingly, prospect theory and the perceived correlation between loss framing and risk-seeking conduct may explain the trend in the data. This suggests that the use of the phrase “bankruptcy as a last resort” causes directors and managers to pursue riskier or less certain restructuring alternatives. For example, in an effort to fix the company’s financial or operational problems and avoid a bankruptcy filing, these directors and managers might agree to an out-of-court refinancing with exceptionally tight covenants and onerous fees and interest rates.

Confirmation and overconfidence biases also might contribute to these decisions. Given the data and the role of heuristics in corporate restructurings, the following respondent narratives are illuminating. Respondents provided the following statements and explained why their clients generally refused to authorize the preparation of a bankruptcy case or the discussion of bankruptcy alternatives in restructuring negotiations:

“[B]elief that other alternatives (additional financing or asset sale or sale of company) would come through before liquidity crises forced filing.”

“Unfounded optimism that management could handle turnaround without benefits of bankruptcy.”

“Client is in denial—something else will ‘rescue’ them from chapter 11.”

“Trying to negotiate a better deal with creditors.”

123. The difference does not reach statistical significance at traditional alpha levels likely due to insufficient power; however, the difference is in the hypothesized direction and trends toward significance ($p=.095$).

*“Unrealistic belief that the lender was actually working WITH them.”*¹²⁴

These statements support the hypothesis that cognitive biases and framing effects influence decisions in the distressed company context.

Prospect theory and heuristics are, however, only one plausible explanation. The study’s findings do not prove a causal link between the phrase “bankruptcy as a last resort” and a client’s ultimate restructuring path. As this Article explains above, the design of the survey limits data analysis and our ability to isolate effects. For example, the respondents who reported that their clients, who initially refused to authorize the preparation of a bankruptcy case and also did not ultimately file a bankruptcy case, might have successfully resolved their clients’ distress in an out-of-court process. Likewise, discussions with, or pressures from, individuals other than the company’s professionals, such as creditors and equity investors, may have influenced the company’s decision. Moreover, the company simply may not have been able to secure debtor-in-possession financing to sustain a bankruptcy case, or the company may have held an asset or business that a filing would have adversely affected. The authors recognize these potential confounding factors and encourage further study of these issues. Nevertheless, the Management Behavior Study offers a first glimpse into distressed companies’ counseling and decision-making processes and should inform future policy decisions.

III. CHANGING THE FRAME TO FACILITATE BETTER RESULTS

An effective bankruptcy system is vital to a well-functioning economy.¹²⁵ It can encourage entrepreneurial activity and spur economic development.¹²⁶ The drafters of the Bankruptcy Code wisely balanced the goals of rehabilitation with value maximization to rehabilitate distressed companies where that end generated the greatest value for all. Notably, many commentators observe that the Bankruptcy Code no longer governs

124. Responses to Management Behavior Study (on file with authors).

125. See, e.g., Donald R. Korobkin, *Value and Rationality in Bankruptcy Decisionmaking*, 33 WM. & MARY L. REV. 333, 335, 354 (1992); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 343–44 (1993).

126. See Amir N. Licht, *The Entrepreneurial Spirit and What the Law Can Do About It*, 28 COMP. LAB. L. & POL’Y J. 817, 856–58 (2007) (noting that bankruptcy can provide entrepreneurs with a fresh start and that entrepreneurs are more likely to live in states with higher bankruptcy exemption levels); see also Warren, *supra* note 125, at 342, 342 n.14 (noting the higher rate of bankruptcy filings among entrepreneurs and small business owners); cf. Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2312, 2316 (2005) (acknowledging some value in Chapter 11 for entrepreneurs but arguing that the current process is inefficient, particularly for serial entrepreneurs).

as intended.¹²⁷ The Bankruptcy Code certainly cannot facilitate successful reorganizations if distressed companies try to avoid its application at all reasonable costs.

This Part considers these observations in light of the Management Behavior Study and proposes potential changes to the restructuring landscape to facilitate more successful failures. It first reviews the existing restructuring landscape and the potential challenges for distressed companies that operate in the current environment. This examination leads to several potential policy and legislative changes to mitigate the real (or perceived) concerns of distressed companies that consider a bankruptcy filing. These proposals focus on one aspect of the U.S. bankruptcy system—hybrid restructurings—and suggest a streamlined process and an incentive structure that work not only for distressed companies but also for their stakeholders.

A. *The Need for Change*

The Bankruptcy Code is the fifth set of federal bankruptcy laws enacted in the United States.¹²⁸ Its predecessor, the Bankruptcy Act of 1898 (the Bankruptcy Act), is the only other long-standing piece of legislation, given the short-lived nature of all prior federal bankruptcy statutes.¹²⁹ Practitioners and policymakers considered reform of the Bankruptcy Act in 1968 because, among other things, public companies resisted Chapter X of the Bankruptcy Act, which was the chapter specifically designated for those cases.¹³⁰ Many of these companies either did not file to obtain the

127. See, e.g., Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 443 (1992) (“[B]ankruptcy’s reallocative provisions, including bankruptcy reorganization, its most pernicious reallocation vehicle, lack justification and [] Congress should abolish them.”); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 751 (2002) (“Corporate reorganizations have all but disappeared. Giant corporations make headlines when they file for Chapter 11, but they are no longer using it to rescue a firm from imminent failure.”); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1088–89 (1992) (“Chapter 11 should be repealed and replaced” because there is no economic benefit from the current model of court-supervised corporate reorganizations); Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 611 (1993) (concluding that Chapter 11 has mixed success and “is not a complete failure”).

128. Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 941 (1979).

129. See Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 13–14, 23, 29–30 (1995) (discussing the frequent and significant changes to bankruptcy laws prior to the Chandler Act, and noting the forty-year period the Chandler Act was in effect).

130. Chapter X broke with the past in that Chapter X replaced with an independent trustee a company’s existing managers, who had previously continued to run the business, and the company’s existing bankers, who had previously run the reorganization. The independent trustee, alone, retained the power to develop the terms of the reorganization. By its terms, it

relief they needed or they tried to qualify for relief under Chapter XI of the Bankruptcy Act, which was designed for small business cases.¹³¹ These developments undercut the value of the Bankruptcy Act and did not serve the interests of public companies or their stakeholders.¹³²

The resulting reforms produced the existing Chapter 11 of the Bankruptcy Code. As this Article discusses above, however, a shift away from Chapter 11—similar to that which occurred in 1950s in the context of Chapter X¹³³—is afoot. The drafters of the Bankruptcy Code indicate that it likely has outlived its shelf life and that it is time once again for reform.¹³⁴ Although many commentators cite several different factors to support reform,¹³⁵ this Article focuses on a factor not yet

required public companies and companies with liabilities in excess of \$250,000 to file in Chapter X; however, companies found a loophole and sought to avoid Chapter X at all costs. SKEEL, *supra* note 45, at 119–20, 162. Moreover, Chapter X could implicate significant government involvement; Chapter X aimed to “afford greater protection to creditors and stockholders by providing . . . impartial and expert administrative assistance in corporate reorganizations through . . . active participation of the SEC.” SEC v. Am. Trailer Rentals Co., 379 U.S. 594, 604 (1965); *see also* Allen F. Corotto & Irving H. Picard, *Business Reorganizations Under the Bankruptcy Reform Act of 1978—A New Approach to Investor Protections and the Role of the SEC*, 28 DEPAUL L. REV. 961, 962 (1979) (discussing SEC involvement in corporate reorganization under Chapter X); Paul R. Glassman, *Solicitation of Plan Rejections Under the Bankruptcy Code*, 62 AM. BANKR. L.J. 261, 262–64 (1988) (discussing the features and workflow of Chapter X); Klee, *supra* note 128, at 942 (noting that Senator Quentin Burdick chaired hearings conducted by the Senate Judiciary Committee in 1968 to determine whether to form a commission to review the bankruptcy laws).

131. The drafters designed Chapter XI, in contrast to Chapter X of the Chandler Act, for small corporate debtors and mom-and-pop firms. Chapter XI allowed the company management to continue to run the business during the reorganization and also allowed the company to choose counsel and professional staff to administer the reorganization process. SKEEL, *supra* note 45, at 162–63.

132. *Id.* at 172 (noting that many large firms that would benefit from a thoughtful reorganization process did not “view[] bankruptcy as part of the ordinary arsenal of weapons for solving corporate problems” during the Chandler Act era, and, as such, filed for bankruptcy “only as an absolute last resort”).

133. *See id.* at 162.

134. *See* Kenneth N. Klee & Richard Levin, *Rethinking Chapter 11*, 21 J. BANKR. L. & PRAC. 5 art. 1 (Nov. 2012) (“[T]he chapter 11 system is itself in distress, having been asked to do far more than it was designed to do . . . [S]everal efforts are underway among the practicing bar to rethink[] chapter 11, with a view toward making it work with today’s (and tomorrow’s) economic and financial system.”). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) is one example of reforms to the current Bankruptcy Code. *See generally* Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603 (2005) (discussing BAPCPA in detail).

135. Klee & Levin, *supra* note 134, art. 1 (considering reform of four areas of reorganization: corporate governance, DIP financing, the “sale of all or substantially all of the business’s assets, and reorganization plan voting and distribution issues”).

discussed in the literature—the underutilization of the Bankruptcy Code.¹³⁶

After a spike in early 2009, the number of Chapter 11 filings has been steadily decreasing.¹³⁷ Commentators acknowledge that fewer companies choose Chapter 11 as a viable restructuring option, and those companies that file are mainly selling or liquidating.¹³⁸ In this respect, bankruptcy really is an option of last resort—a place where companies go to die. Any changes to this emerging reality will take more than a few legislative tweaks, and a complete overhaul of the bankruptcy system is beyond the scope of this Article. Nevertheless, this Article focuses on one critical component of the current and any future bankruptcy legislation: the creation of a nonthreatening environment and streamlined process that distressed companies (and their creditors) willingly embrace.

B. Encouraging More Hybrid Restructurings

A thoughtful study by the World Bank defines hybrid restructurings as “workout procedures in which there is a mixture of the features of contractual workouts and limited court intervention.”¹³⁹ The World Bank discusses hybrid procedures as one alternative in its “continuum of procedures for the treatment of financial difficulties.”¹⁴⁰ Likewise, this Article contemplates the use of hybrid restructurings as part of a robust system for distress resolution.

In the United States, the prepackaged and, to some extent, the prearranged Chapter 11 cases represent hybrid restructurings. As Subsection I.A.3 discusses, however, both alternatives are limited in application and utility. Neither alternative is available to all distressed companies; rather, companies generally need a small group of creditors,

136. See *supra* Subsection I.A.2.

137. Jacob Barron, *Commercial Bankruptcies Down 22% in 2012*, NAT'L ASS'N CREDIT MGMT. BLOG (Jan. 8, 2013), <http://blog.nacm.org/blog/jake-blog/commercial-bankruptcies-down-22-in-2012>; Jonathan Carson & Michael Frishberg, *Mapping Administrative Strategies to Changing Paradigms of Chapter 11*, ASPATORE (Sept. 2010), 2010 WL 3650164, at *2; *Bankruptcy Filings Down in Fiscal Year 2012*, U.S. CTS. (Nov. 7, 2012), <http://news.uscourts.gov/bankruptcy-filings-down-fiscal-year-2012>.

138. Robert D. Wilcox, *The Current Bankruptcy Environment: What Lawyers Need to Know*, ASPATORE, (Nov. 2010), 2010 WL 4735524, at *1, *2, *7 (noting that companies perceive the Chapter 11 alternatives as a better choice for reorganization and that companies increasingly use bankruptcy as a way to sell assets free and clear of liabilities rather than for reorganization). In addition, some practitioners see a pronounced spike in creditor use of receivership proceedings, which may or may not also include a Chapter 11 proceeding. Jeffrey R. Barber, *Shifting Economic Landscape, Shifting Legal Strategies: The Increased Use of Receivership Proceedings and Selected Bankruptcy Trends*, ASPATORE (Feb. 2011), 2011 WL 586145, at *1.

139. GARRIDO, *supra* note 56, at 47.

140. *Id.* at 3.

limited financial or operational problems, or a certain capital structure to invoke either a prepackaged or prearranged process successfully.¹⁴¹ Moreover, a distressed company that tries but fails to implement one of these hybrid restructurings receives little, if any, credit for those efforts in any subsequent bankruptcy case.

Despite these challenges, hybrid restructurings are an important key to unlocking the potential value of the bankruptcy process for many companies. If companies implement hybrid restructurings appropriately, then they can encourage earlier acknowledgement of distress, more meaningful restructuring negotiations with a broader group of constituencies, and more efficient resolutions. Any such structure, however, must integrate incentives and tools to mitigate some of the heuristics the Management Behavior Survey identifies. The “meet and confer” process this Article discusses below combines certain advantages of a formal bankruptcy filing with the flexibility and speed of an out-of-court restructuring as well as the enhanced options for companies that proactively manage their distress.

1. Overview of Meet and Confer

The meet and confer process (the MCP) would facilitate broad restructuring negotiations in the shadows of a formal bankruptcy case, but with more certainty and greater restructuring options than the current prepackaged or prearranged plan process. A company could file a notice in the appropriate district or bankruptcy court (the MC Notice) and initiate an MCP.¹⁴² This notice would identify the company and any affiliates involved in the MCP; the company’s secured creditors; the company’s stakeholder committee (discussed below); and the name of a proposed facilitator to assist the parties in their discussions and the development of a proposed plan.¹⁴³ The MC Notice would trigger a short standstill period, which would enjoin creditors from the exercise of their collection rights against the company, and the company could pay only ordinary course business expenses.¹⁴⁴ The MCP could end in one of several ways: the company’s commencement of a formal case primarily to solicit acceptance and confirmation of the negotiated plan; the company’s commencement of a formal, more traditional case with enhanced options (e.g., a longer exclusive period to file a plan and additional time to determine treatment of contracts and leases); or the company’s dismissal of the MC notice (e.g., the key parties either reach

141. See *supra* Subsection I.A.3.

142. The mechanics of the filing process could be similar to those that § 301 of the Bankruptcy Code uses for the filing of a bankruptcy petition. 11 U.S.C. § 301 (2006). The primary difference would be in the effect of the filing and the resulting process.

143. See *infra* Subsection III.B.2.

144. See *infra* Subsection III.B.3.

a consensual out-of-court plan that does not require court implementation or they agree that the state law should govern the company's reorganization).¹⁴⁵

The MCP would strive to create a stable and productive environment for the distressed company and its creditors. The standstill and contemplated multiparty negotiation format would allow the parties to focus on the causes and potential resolution of the company's distress without the distractions and often counterproductive noise that surrounds the first days of a formal bankruptcy case.¹⁴⁶ Although still a quasi-judicial process, directors and managers may feel less threatened by the MCP because the process would not force them to operate inside of a fishbowl during what is often the most sensitive period of restructuring negotiations. They also would retain authority to dismiss the MCP at any point, but would receive "credit" for their efforts if they ultimately decide a formal, more traditional case is necessary.¹⁴⁷ In many ways, the MCP offers great potential upside with little downside risk. It is a restructuring alternative that seeks to shift the bankruptcy discussion to a gain frame and promote more timely utilization by distressed companies.¹⁴⁸

2. The MC Notice and the Parties

A traditional bankruptcy filing requires a large amount of preparation, paperwork, and effort.¹⁴⁹ Those elements can distract management and professionals from core issues that surround the company's distress and cause management to doubt the value of the bankruptcy process. As one respondent to the Management Behavior Study observed, clients resisted preparation of a bankruptcy filing because of "[c]ost and the fact that the

145. See *infra* Subsection III.B.4.

146. See David Anthony, *Big New Case in Nashville Bankruptcy Court*, CREDITORS RIGHTS 101 BLOG (June 12, 2012), <http://creditorsrights101.com/tag/first-day-motions> (discussing the excitement for first-day motions in larger Chapter 11 cases); AMERICAN BANKR. INST., ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11 FIELD HEARING: MINUTES/SUMMARY (Nov. 30, 2012), http://commission.abi.org/sites/default/files/ABI%20Commission%20Minutes%20Nov_30_2012.docx/ (discussing the complexity of first day motions hearings).

147. See *infra* Subsection III.B.4.

148. See *supra* Subsection I.B.2 (discussing CEO risk-taking to avoid a perceived failure in filing for bankruptcy); cf. Kahneman, *supra* note 83, at 1456 (noting that when decision-makers face certain loss, they engage in more risk-seeking behavior).

149. FED. R. BANKR. P. 1002 (providing that voluntary case is commenced by filing petition with the court); FED. R. BANKR. P. 1007 (noting the various lists, schedules, statements, and other documents that must accompany the petition). For a discussion of first-day motions practice, see generally Jay M. Goffman & Grenville R. Day, *First Day Motions and Orders in Large Chapter 11 Cases: (Critical Vendor, DIP Financing and Cash Management Issues)*, 12 J. BANKR. L. & PRAC. 59, 63–73 (2003).

results that might be achieved did not justify the risk.”¹⁵⁰ The MCP lowers entry barriers to the types of restructuring negotiations that formal cases often facilitate.

The MC Notice would invoke the jurisdiction of the court primarily to enforce the standstill period this Article discusses below¹⁵¹ and to streamline the commencement of a formal case when such is the exit strategy of choice that follows the MCP. Only a company, as debtor, could file an MC Notice, and the court could require affidavits from the company’s top executives and professionals that certify that the company filed the notice in good faith and in accordance with the statutory requirements.¹⁵² The applicable statute could include appropriate safeguards and allow a company to file an MC Notice only if it is not in default or subject to a notice of default under any of its secured credit obligations or some set percentage of its unsecured debt; if it does not file the MC Notice in response to a specific enforcement action or litigation matter; and if it did not file a bankruptcy case or MC Notice in the past 180 days (or some other appropriate period). These requirements ultimately should be designed to deter parties who use the MCP as a delay tactic and to encourage parties to initiate the restructuring negotiations earlier in the company’s distress.

The MC Notice would identify the key parties to the restructuring negotiations. In addition to the company’s secured creditors, the company should identify representatives of its major unsecured creditor groups and interest holders to form its stakeholder committee.¹⁵³ The company should ground the stakeholder committee in type of interest, rather than size of those interests, to ensure a dynamic discussion of the company’s restructuring options.¹⁵⁴ The company would pay the fees

150. Response to Management Behavior Study (on file with authors).

151. See *infra* Subsection III.B.3.

152. Creditors who wish to file an involuntary petition against a debtor must meet the initial conditions. If the court dismisses their case, the court may require the creditors to pay costs, or, if the court determines that the creditors filed the involuntary petition in bad faith, the court may subject the creditors to significant damages. 11 U.S.C. § 303(b), 303(i) (2006).

153. Michelle M. Harner & Jamie Marincic, *Committee Capture? An Empirical Analysis of the Role of Creditors’ Committees in Business Reorganizations*, 64 VAND. L. REV. 749, 754 (2011) (“A creditors’ committee is designed to protect and promote the interests of general unsecured creditors.”); *id.* at 781, 784, 788–89 (discussing performance of creditors’ committees in promoting unsecured creditors’ interests); Michelle M. Harner & Jamie Marincic, *Behind Closed Doors: The Influence of Creditors in Business Reorganizations*, 34 SEATTLE U. L. REV. 1155, 1161 (2011) (“[T]he creditors’ committee often is central to ensuring a fair and successful reorganization process.”); Kelli A. Alces, *The Equity Trustee*, 42 ARIZ. ST. L.J. 717, 717 (2010) (suggesting a role for a shareholder representative “to do the shareholder job of monitoring management”).

154. Michelle M. Harner & Jamie Marincic, *The Potential Value of Dynamic Tension in Restructuring Negotiations*, AM. BANKR. INST. J., Feb. 2011 (discussing how competing agendas, along with active engagement in a bankruptcy case—i.e., the dynamic tension—may

for counsel the stakeholder committee selects and retains, provided that the company could request that the court order a member of the committee or any secured creditor to pay its own counsel and other advisor fees upon a showing of bad faith or obstructionist conduct by that party.

The MC Notice also would identify a third-party neutral to serve as facilitator in the restructuring negotiations.¹⁵⁵ The facilitator should be completely disinterested in the matter.¹⁵⁶ The facilitator's primary objective should be to foster meaningful and informed dialogue among the parties and assist the company in its evaluation of its restructuring alternatives. The facilitator also might serve a valuable and ongoing role in any subsequent formal bankruptcy case.¹⁵⁷

3. The Standstill

The standstill period is necessary to create a stable and safe environment for the restructuring negotiations. Under existing U.S. laws that govern hybrid procedures, companies can obtain a standstill only through a contractual agreement with their creditors in an out-of-court proceeding.¹⁵⁸ Because the MC Notice triggers the quasi-judicial nature of the MCP, it permits a broader standstill agreement that levels the playing field and allows more parties a seat at the negotiating table, but

result in better outcomes for those cases).

155. Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 475 (2011) (discussing a role for a third-party neutral who could serve as an objective party, and facilitate the flow of information, with the ultimate goals of reducing conflict, correcting information asymmetries, and enhancing estate value for all stakeholders); *id.* at 516–17 (noting how the use of third-party neutrals, or “case facilitator,” experienced limited success in the United Kingdom in its encouragement of out-of-court workouts as well).

156. *Id.* at 508 (“[L]ack of independence may create biases and increase rather than resolve conflicts in the restructuring.”). A “disinterested person” is defined in 11 U.S.C. § 101(14) (2006) as:

a person that—(A) is not a creditor, an equity security holder, or an insider; (B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and (C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.

Id.

157. Harner, *supra* note 155, at 473, 475 (noting that intercreditor conflict in bankruptcy can erode the value of the estate and discussing a role for a third-party neutral who could ameliorate much of the conflict and assist the bankruptcy court).

158. *See supra* Subsection I.A.3.

it does not tip the scales dramatically in favor of any one party.¹⁵⁹ Nevertheless, policymakers should craft carefully the legislation implementing the standstill period and tailor it to serve the objectives of the process while preserving all parties' rights if the process fails.

For example, if the company qualifies for an MCP, the initial standstill could last sixty days, with a possible thirty-day extension.¹⁶⁰ During the standstill period, creditors would be enjoined from pursuit of their collection rights against the company.¹⁶¹ The company in turn would be permitted to pay only ordinary course business expenses and would be required to stay current on those expenses, as well as any interest or other current obligations under its funded debt (absent an agreement to the contrary with the affected creditors). Notably, these standards would require a company to invoke an MCP prior to any liquidity crises or major defaults on funded debt.

4. The MCO Exit Plan

The MCP would have no required or preconceived exit strategy. Although most companies could invoke the process to work towards a restructuring plan that resolves its distress, that plan might not

159. In France:

[s]afeguard proceedings are aimed at improving the chances of survival of a company facing difficulties by anticipating the situation at an early stage and seeking to negotiate a safeguard plan with its creditors to ensure the continuation of the company's business, to maintain employment and to restructure the company's indebtedness Safeguard proceedings can only be initiated by a debtor company if it is solvent and demonstrates that it is encountering difficulties that it is not able to overcome.

Rod Cork & Marc Santoni, *France: Restructuring and Insolvency Procedures*, INT'L FIN. L. REV. (Mar. 1, 2009), <http://www.iflr.com/Article/2166556/France-Restructuring-and-insolvency-procedures.html>.

160. The process also could contemplate longer extensions with the consensus of a majority or supermajority of the parties identified in the MC Notice. Notably, a voluntary standstill agreement between a debtor and its creditors is a central feature of many out-of-court restructuring approaches, which include the London Approach and the related INSOL Principles that the INSOL Lenders Group developed. See Esteban C. Buljevich, *The Workout Decalogue: The New Global Approach to Debt Restructurings*, in CROSS-BORDER DEBT RESTRUCTURINGS: INNOVATIVE APPROACHES FOR CREDITORS, CORPORATES AND SOVEREIGNS 1, 8, 15 (2005), available at <http://www.euromoneyooks.com/images/covers/Cross-Border%20Debt%20Restructurings%20Innovative%20Approaches%20for%20Creditors%20Corporates%20and%20Sovereigns/Debt%20ch1.pdf>. In addition, some countries seek to facilitate similar out-of-court workouts through legislation. See *id.* at 11–12.

161. The MCP statute would need to preserve the status quo among the company and its creditors during the standstill period. Accordingly, the statute would need to toll any applicable deadlines that relate to creditors' enforcement rights. 11 U.S.C. § 108(c) (2006) (tolling certain claims against debtors, so long as the original period to file the claim against the debtor has not expired before the debtor files its bankruptcy petition).

materialize through the process or it might take any number of forms or may not materialize through the process. If a plan emerges that incorporates aspects of the Bankruptcy Code, such as a sale of assets, a debt-for-equity exchange that eliminates existing equity holders, or the rejection of contracts or leases, the company could commence a streamlined formal bankruptcy case upon the conclusion of the MCP to solicit acceptances and confirmation of the plan.¹⁶² If a plan can be accomplished consensually and without the need for court approval, the company could simply dismiss the MC Notice and proceed to implement the plan outside of any formal case.¹⁶³

Likewise, if a company completes the MCP and no plan emerges, the company could dismiss the MC Notice and try to continue operations and restructuring discussions without any formal bankruptcy case. Alternatively, if the company wanted to commence a formal, traditional case under either Chapter 7 or 11 of the Bankruptcy Code, it could do so. The statute could recognize or reward the company's proactive efforts in the MCP if it provides special treatment for MCP debtors. For example, the MCP debtor could receive a longer exclusive period to file and solicit acceptances of its plan; it could receive additional time to elect to assume or reject contracts and leases (including commercial leases); and it could receive the benefit of streamlined disclosures (particularly if the facilitator remains in the case and files status reports with the court).¹⁶⁴

The exit elements of the MCP would prove important to counter several of the heuristics this Article discusses above.¹⁶⁵ The contemplated structure would allow directors and managers to test the bankruptcy process in several respects without incurring significant costs, facing intense public scrutiny, or losing control of the company's alternatives if the MCP fails.¹⁶⁶ The short duration of the initial standstill period and the involvement of multiple parties, which include

162. *See, e.g., id.* § 363(b)(1) (permitting the trustee to sell, use, or lease property of the estate, when not in the ordinary course of business, but only after notice and a hearing); *id.* § 365(a) (permitting the trustee to assume or reject an executory contract or expired lease of the debtor subject to the courts' approval); *id.* § 1126 (discussing plan acceptance for parties whose claim the plan impairs).

163. *See supra* Subsection I.A.1.

164. Several sections of the Code may need modification to accommodate special MCP treatment. *See, e.g.,* 11 U.S.C. § 365(d)(4) (limiting the period during which the debtor can reject an unexpired commercial lease to 120 days, with the ability to extend the period for a maximum of 90 days for cause); *id.* § 1121 (specifying time periods for the debtor, exclusively, to file and solicit votes on a plan and also limiting the opportunity to extend that period).

165. *See supra* Section I.B.

166. *See supra* Section I.B.

a disinterested facilitator, would mitigate abusive or wrongful conduct by the company's directors and managers.¹⁶⁷

5. The Potential Benefits

Several respondents in the Management Behavior Study discuss the "extreme" nature of a bankruptcy filing and the potential unknown or unintended consequences. As one respondent explains, clients resist bankruptcy alternatives because it is the "most extreme option; it leaves interim solutions out."¹⁶⁸ The MCP creates a quasi-bankruptcy or hybrid restructuring alternative that addresses these and other issues and fosters discussion of bankruptcy options as something other than a last resort.¹⁶⁹

The requirements to invoke the MCP and the standstill period encourage companies and professionals to discuss the option before the company's distress becomes too severe.¹⁷⁰ A company in default or a defensive posture with its creditors likely will not qualify for the process. The MCP recognizes the value in addressing distress when there is still a viable company to restructure and rewards management who adopt this proactive strategy.

Moreover, although a quasi-bankruptcy process, the MCP statute would neither designate as a "debtor" the company that invoked an MCP nor subject it to a bankruptcy case. This distinction might be meaningless to some, but incredibly important to others. Specifically, the non-bankruptcy nature of the MCP itself, the minimal (if any) disruption of operations, and the elimination of the noise typically associated with the first days of a bankruptcy case could be significant differences for many. In this context, an MCP may reduce significantly the representative issues and related heuristics that might impede an executive's decisions with respect to a traditional bankruptcy case.¹⁷¹

167. See *infra* Subsection III.B.6.

168. Response to Management Behavior Study (on file with authors).

169. "According to the World Bank Principles, an effective [restructuring] system should include, '*Laws and procedures that flexibly accommodate a broad range of restructuring activities*' . . . [and] should be flexible enough to allow the use by creditors and debtors of a wide array of restructuring techniques." GARRIDO, *supra* note 56, at 20. Moreover, the MCP would result in less reputational damages and carry less stigma than a formal process. See *id.* at 10.

170. See *supra* Subsections III.B.2–3.

171. See *supra* Section I.B.

6. The Potential Challenges

The MCP tries to strike an appropriate balance among the competing interests of a distressed company and all of its constituencies; the different types and causes of distress; and the authority and accountability of the distressed company's management. The balance is delicate and likely subject to criticism. For example, some creditors may believe that the standstill is too long or onerous.¹⁷² Others may argue against the company's role as the only party that can initiate the MCP or an exit strategy.¹⁷³ Still others may seek to eliminate the proposed advantages to an MCP debtor in a subsequent Chapter 7 or Chapter 11 case.¹⁷⁴

This Article addresses each of these and other potential issues in the outline of the proposal above, and they are fair points worthy of consideration.¹⁷⁵ As with any proposal, the devil would be in the details of the MCP statute, and the drafters would need to carefully evaluate these issues when they draft the qualification standards and the standstill parameters. In addition, the statute would need to include provisions that address abuses of the process by either the distressed company or stakeholders and the consequences of such conduct. The MCP discussion in this Article is a framework to guide deliberations of the competing considerations and help develop an appropriate hybrid restructuring process. The end goal should be to devise a structure that highlights the potential utility of a bankruptcy or quasi-bankruptcy process and engenders a positive or gain frame perception among professionals and business executives.¹⁷⁶

CONCLUSION

The data this Article presents confirm what many commentators and practitioners long expected—management typically resists consideration of a bankruptcy case until it is arguably too late to use that restructuring tool effectively. This finding is particularly relevant in the current environment where an increasing number of distressed companies appear to file bankruptcy cases only to sell their assets or liquidate. These companies generally do not use bankruptcy to reorganize their businesses. The attendant loss of jobs and revenue is striking.

This Article and the Management Behavior Study offer the first empirical glimpse into a potential contributing factor to this trend—

172. *See supra* Subsection III.B.3.

173. *See supra* Subsections III.B.2, III.B.4.

174. *See supra* Subsection III.B.4.

175. *See supra* Subsections III.B.2–4.

176. *See supra* Subsections I.B.2, III.B.1; *see also* Kahneman, *supra* note 83, at 1456.

management heuristics, cognitive biases, and loss framing. The study shows a prevalent description of bankruptcy as an “option of last resort.” This approach may enable risk-seeking conduct by management, a behavioral tendency to which management may be predisposed given studies that suggest management’s susceptibility to confirmation and over-confidence biases. As one respondent to the Management Behavior Study explains, management possesses “[u]nfounded optimism that [it] could handle turnaround without benefits of” the Bankruptcy Code.¹⁷⁷

The meet and confer process this Article describes is designed to counter several of these heuristics and encourage more thoughtful discussions of the role of bankruptcy or quasi-bankruptcy tools in restructuring negotiations.¹⁷⁸ The MCP allows management control over the timing and exit strategy that the process develops, but promotes more timely consideration of the company’s distress through the qualification standards and standstill parameters that the process integrates. It further strikes a delicate balance between the requisite incentives that foster management engagement and the requisite protections that preserve creditors’ rights throughout the process. At its core, the MCP strives to help management recognize distress for what it *might* be—an opportunity to facilitate a successful failure.¹⁷⁹

177. Response to Management Behavior Study (on file with authors).

178. See *supra* Sections I.B., III.B.

179. See, e.g., Sergio Marchionne, CEO, Chrysler Group LLC, A Year of Transformation, Address at the NADA/IHS Global Insight Automotive Forum (Mar. 30, 2010) (video recording available at <http://blog.chryslerllc.com/blog.do?p=day&ds=30032010>) (“The presentation of our plan in November last year was entitled ‘From Chapter 11 to Chapter 1,’ as it represents a new beginning for Chrysler. It is our road map for creative reconstruction.”).

APPENDIX A

Your Experiences in the Field: Working with Distressed Clients

Q1 **NOTE: For purposes of this survey, the phrase “distressed client(s)” means business entity clients (both incorporated and unincorporated entities) that are experiencing or should anticipate experiencing financial distress, such as actual or potential loan defaults, liquidity issues, litigation risks, operational issues, balance sheet insolvency or equitable insolvency.**

Some people say that filing bankruptcy is “an option of last resort” or “an option only if all other alternatives fail.” Have you ever used these phrases or one like it to describe the filing of bankruptcy to any of your distressed clients?

☐ Yes

☐ No

Q2 **In the past 5 years, with approximately how many of your distressed clients have you used such a phrase or phrases?**

☐ All

☐ Most

☐ Approximately half

☐ Some

☐ None

Q3 **Which of the following best describes what you mean by such a phrase or phrases?**

☐ Distressed client should file a bankruptcy case only after exhausting all of its out-of-court restructuring alternatives.

☐ Distressed client should file a bankruptcy case only if necessary to prevent creditors from exercising default remedies.

☐ Distressed client should file a bankruptcy case only if it represents the alternative most likely to preserve or maximize value.

☐ Other (please specify)

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Your Experiences in the Field: Working with Distressed Clients

Q4 What is the most common reason you describe a bankruptcy filing in that manner?

☐ Cost and delay associated with bankruptcy case

☐ Uncertainty associated with bankruptcy case

☐ Loss of debtor control in bankruptcy case, including in chapter 11 case

☐ Loss of creditor control in bankruptcy case, including in chapter 11 case

☐ Other (please specify):

Q5 Have you ever had a distressed client refuse to authorize you to prepare materials to file a potential bankruptcy case at the time you thought was appropriate?

☐ Yes

☐ No

Q6 Did any of these distressed clients ultimately file a bankruptcy case?

☐ Yes

☐ No

Your Experiences in the Field: Working with Distressed Clients

Q7 Which of the following is the MOST common reason for the distressed client's reluctance to authorize you to prepare materials to file a potential bankruptcy case at the time you thought was appropriate?

- ☐ Perceived stigma associated with bankruptcy
- ☐ Concern about impact on customers and sales
- ☐ Concern about impact on company's relationships with supply chain and vendors
- ☐ Belief that financial difficulties were temporary or short-term in nature
- ☐ General denial about financial or operational obstacles facing company
- ☐ Management loss of control and creditor oversight of process
- ☐ Disagreement among management
- ☐ Other (please specify)

Q8 Which of the following is the SECOND most common reason for the distressed client's reluctance to authorize you to prepare materials to file a potential bankruptcy case at the time you thought was appropriate?

- ☐ Perceived stigma associated with bankruptcy
- ☐ Concern about impact on customers and sales
- ☐ Concern about impact on company's relationships with supply chain and vendors
- ☐ Belief that financial difficulties were temporary or short-term in nature
- ☐ General denial about financial or operational obstacles facing company
- ☐ Management loss of control and creditor oversight of process
- ☐ Disagreement among management
- ☐ Other (please specify)

Q9 Have you ever had a distressed client refuse to authorize you to discuss the filing of a potential bankruptcy case in negotiations with creditors at the time you thought was appropriate?

- ☐ Yes
- ☐ No

Your Experiences in the Field: Working with Distressed Clients

Q10 Did any of those distressed clients ultimately file a bankruptcy case?

☐ Yes

☐ No

Q11 Which of the following is the MOST common reason for the distressed client's reluctance to authorize you to discuss the filing of a potential bankruptcy case in negotiations with creditors at the time you thought was appropriate?

☐ Perceived stigma associated with bankruptcy

☐ Concern about impact on customers and sales

☐ Concern about impact on company's relationships with supply chain and vendors

☐ Belief that financial difficulties were temporary or short-term in nature

☐ General denial about financial or operational obstacles facing company

☐ Management loss of control and creditor oversight of process

☐ Disagreement among management

☐ Other (please specify)

Q12 Which of the following is the SECOND most common reason for the distressed client's reluctance to authorize you to discuss the filing of a potential bankruptcy case in negotiations with creditors at the time you thought was appropriate?

☐ Perceived stigma associated with bankruptcy

☐ Concern about impact on customers and sales

☐ Concern about impact on company's relationships with supply chain and vendors

☐ Belief that financial difficulties were temporary or short-term in nature

☐ General denial about financial or operational obstacles facing company

☐ Management loss of control and creditor oversight of process

☐ Disagreement among management

☐ Other (please specify)

Your Experiences in the Field: Working with Distressed Clients	
Q13	<p>Which of the following parties is the MOST likely to dictate—as a practical, rather than legal, matter—the timing of any bankruptcy filing in the majority of your cases?</p> <p><input type="checkbox"/> The distressed company's board of directors</p> <p><input type="checkbox"/> The distressed company's Chief Executive Officer or Chief Financial Officer</p> <p><input type="checkbox"/> The distressed company's Chief Restructuring Officer</p> <p><input type="checkbox"/> The distressed company's secured lenders</p> <p><input type="checkbox"/> The distressed company's unsecured creditors, including any unsecured bondholders</p> <p><input type="checkbox"/> The distressed company's professionals</p> <p><input type="checkbox"/> Other (please specify)</p> <div style="border: 1px solid black; height: 15px; width: 200px; margin-top: 5px;"></div>
Q14	<p>Which of the following parties is the SECOND most likely to dictate—as a practical, rather than legal, matter—the timing of any bankruptcy filing in the majority of your cases?</p> <p><input type="checkbox"/> The distressed company's board of directors</p> <p><input type="checkbox"/> The distressed company's Chief Executive Officer or Chief Financial Officer</p> <p><input type="checkbox"/> The distressed company's Chief Restructuring Officer</p> <p><input type="checkbox"/> The distressed company's secured lenders</p> <p><input type="checkbox"/> The distressed company's unsecured creditors, including any unsecured bondholders</p> <p><input type="checkbox"/> The distressed company's professionals</p> <p><input type="checkbox"/> Other (please specify)</p> <div style="border: 1px solid black; height: 15px; width: 200px; margin-top: 5px;"></div>

Your Experiences in the Field: Working with Distressed Clients

Q15 Which of the following parties is the most likely to dictate—as a practical, rather than legal, matter—WHETHER AND WHEN the distressed company hires a Chief Restructuring Officer?

- ☐ The distressed company's board of directors
- ☐ The distressed company's Chief Executive Officer or Chief Financial Officer
- ☐ The distressed company's secured lenders
- ☐ The distressed company's unsecured creditors, including any unsecured bondholders
- ☐ The distressed company's professionals
- ☐ Other (please specify)

Q16 Which of the following parties is the most likely to dictate—as a practical, rather than legal, matter—the IDENTITY of the Chief Restructuring Officer hired by the distressed company?

- ☐ The distressed company's board of directors
- ☐ The distressed company's Chief Executive Officer or Chief Financial Officer
- ☐ The distressed company's secured lenders
- ☐ The distressed company's unsecured creditors, including any unsecured bondholders
- ☐ The distressed company's professionals
- ☐ Other (please specify)

Q17 What is your profession?

- ☐ Lawyer
- ☐ Financial Adviser
- ☐ Investment Banker
- ☐ Other (please specify)

Your Experiences in the Field: Working with Distressed Clients

Q18 Which of the following best describes your professional role in bankruptcy or distressed matters?

- ☐ Professional to distressed companies in more than 50% of matters
- ☐ Professional to secured creditors in more than 50% of matters
- ☐ Professional to unsecured creditors in more than 50% of matters
- ☐ Professional to equity holders in more than 50% of matters
- ☐ No one type of representation consumes a majority of your professional matters
- ☐ Other (please specify)

Q19 For how many years have you worked in a professional capacity in bankruptcy or distressed matters?

- ☐ 5 years or fewer
- ☐ More than 5 years but fewer than 10 years
- ☐ 10 - 15 years
- ☐ More than 15 years

Q20 How many lawyers, advisers, or bankers, as applicable, work for your firm?

- ☐ 25 or fewer
- ☐ 26 - 50
- ☐ 51 - 100
- ☐ 101 - 500
- ☐ 501 or more

Your Experiences in the Field: Working with Distressed Clients

Q21 What is the average size of bankruptcy or distressed matters on which you work, based on debtor's assets?

- ☐ Debtor's assets estimated at \$100 million or less
- ☐ Debtor's assets estimated between \$101 million and \$250 million
- ☐ Debtor's assets estimated between \$251 million and \$500 million
- ☐ Debtor's assets estimated between \$501 million and \$999 million
- ☐ Debtor's assets estimated at \$1 billion or more

Q22 Please provide any additional comments you would like to share regarding factors impacting a distressed company's or creditors' decisions regarding when or if a bankruptcy case is filed.

